

Compensation Forfeiture:

Stacking Remedies Against Disloyal Agents and Employees

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Introduction

"This is equity, not rocket science."¹

The median CEO compensation package for the top 100 highest paid CEO's was worth \$23.7 million in 2014.² That's much more than we pay the President of the United States or justices of the Supreme Court but it is similar to the median for the 100 highest paid athletes in the world of \$ 23.95 million (including endorsement income.)³ Those who believe that executives are overpaid may find some solace in the fact that when a senior business executive is sued for breach of fiduciary duty, one of biggest penalties that he faces will be in proportion to his elevated compensation. From that point of view, the effect of forfeiting three to five years of gross compensation can be similar to that of an akido expert who turns the momentum of his opponent against him, i.e. forfeiture turns the defendant's high compensation into a large potential liability for disloyalty.

Compensation forfeiture is a simple but substantial enhancement to increase the total relief for a given breach of fiduciary duty. Thus, if the principal proves that the fiduciary accrued a hidden profit, the principal will secure the disgorgement of the profit and, in addition, can plead for compensation forfeiture for the same disloyalty. It may constitute a principal's only remedy and it frequently exceeds compensating and consequential damages. Pleading for forfeiture does not exclude any other damage claim or remedy and requires no special proof or expert testimony. The principal or employer can readily identify and prove the measure of the compensation that includes the fiduciary's salary, commissions, fees bonuses and retirement benefits. Grants of stock or stock options can also be forfeited in kind as specific restitution in equity.

The principles underlying compensation forfeiture against disloyal fiduciaries date back in the law in equity to before 1600. When the fiduciary's act of disloyalty is regarded as a breach of an implied condition that the fiduciary will be loyal, compensation forfeiture also has support in contract law.

¹ In re Alpha Telecom, Inc., No. CV 01-1283- PA, 2004 U.S. Dist. LEXIS 20002, at 29 (D. Or. August 18, 2004).

² Press Release May 18, 2015, Equilar and The New York Times Release Top 200 Highest-Paid CEO Ranking 2015

³ According to Forbes' The Worlds 100 Highest Paid Athletes in 2015, the median pay including endorsement income was \$ 23.95 million average pay and the average was \$ 32 million. By category of sport the average pay after endorsement income and the number of athletes in each category are as follows: boxing (\$160.8 for 3); tennis (\$ 34.8 for 7); golf (\$ 34.8 for 6); soccer (\$32.3 for 15); cricket (\$31.0 for 1); racing (\$30.1 for 6); basketball (\$29.3 for 18); football (\$25.6 for 16); baseball (\$23.3 for 27); and track (\$21.0 for 1).

The dual goals for remedying a breach of fiduciary duty can lead to multiple remedies for a single cause of action which include a mix of remedies in equity and at law. When both types of remedies are awarded and 'stacked' on top of one another they may overlap and result in windfall to the plaintiff because they do not dovetail or mesh well together. When the remedy package includes disgorgement, compensation forfeiture and punitive damages it consists of three remedies that is each intended to deter future disloyalty but that deterrence can only be collectively justified by the myopic belief that if some award deters, more award will deter more. However, in the relatively small number of cases in which the remedy was awarded against rank and file employees, compensation forfeiture did pose a risk for abuse as a device for the employer to try to control employees' personal lives.

As awarded in most courts today, compensation forfeiture is applied in a manner similar to punitive damages as the compensation forfeiture is added on top of other remedies when the defendant's disloyalty is found to warrant such an additional remedy. This premium or enhancement is frequently hidden in other remedies in equity such as disgorgement or an accounting which generally deny the disloyal fiduciary's compensation as a legitimate expense.

The term of 'breach of fiduciary duty' or even 'disloyalty' fails to suggest the emotional dimension or the impact of the fiduciary's betrayal that is evidenced by the principal. Some courts have acknowledged that the egregiousness of the defendant's behavior can have an impact on the finding of liability and the amount of the damage measures.⁴ Especially in cases with egregious or prejudicial facts, forfeiture's role as quasi-punitive damages may also be heightened. At times, the sum of compensation forfeiture and punitive damages can exceed 500% of the plaintiff's compensating and consequential damages. Even without the specific intent to do so, the award of remedy packages with such high ratios should be expected to frequently have the effect of financially ruining the defendant.

If disloyal executives were a rational group of fiduciaries who weigh risks and rewards, the threat of forfeiting three to five years of their gross compensation would deter all but the largest schemes of fraud and theft. Yet for many of the executives described in this article, the

⁴ See George P. Roach, Texas Remedies in Equity for Breach of Fiduciary Duty: Disgorgement, Forfeiture, and Fracturing, St. Mary's Law Journal 2014, 45 St. Mary's L.J. 367, notes 268 to 277 and accompany text (describing how particularly egregious case facts relating to betrayal changed the law in two cases in remedies law.) **See also** 1 Dan B. Dobbs, Law of Remedies, § 4.1(3), at 565 (2d. Ed. 1993) ("If the wrong is bad enough, even a radical remedy that captures the defendant's own property to protect the plaintiff's rights may be acceptable." (citations omitted)); Id. at § 4.5(3), at 645.

dollar amount of proven gains to the defendants was only a fraction of the amount of compensation forfeiture they lost. The basic irrationality of the defendants is further confirmed by the fact that they were highly compensated and did not need to steal and by their refusal to reconcile or confess at any point along the road to their being fired, convicted and, finally, ruined.

The article first considers the cases of four innovative and successful (albeit felonious) CEO's in Section II on corporate outlaws. The review of the case opinions reveals that compensation forfeiture amounted to a majority of the non-punitive damages in each case. Section III briefly evaluates how the characteristics of a claim for breach of fiduciary duty promotes a combination of remedies of great variety. Section IV discusses the key elements and issues in advocating or defending a claim of compensation forfeiture. Section V will briefly discuss some alternative approaches (asset forfeiture and innocent misrepresentation) that are sometimes employed in fiduciary or related claims.

Often an article is shaped for better or worse by the choices employed on limits and boundaries to its scope. In this article, while cases relating to fiduciary claims against lawyers are included, the current controversy about dual claims for legal malpractice and breach of fiduciary duty is not addressed in the detail it deserves. Alternative remedies in equity are discussed only in comparison with or in combination with forfeiture.

Given the article's national scope, generalizations supported by examples from a variety of the jurisdictions that support or modify the main view can only highlight some of the key issues to consider without fully considering each state's position on each issue. Opinions from New York, Illinois, Texas, California and Massachusetts will receive disproportionate attention because their courts are the most active jurisdictions for the remedy.

The article will manifest certain semantic preferences that should be noted. In the belief that the term 'equitable' is a semantic chameleon that can be misunderstood easily, it is used as infrequently as possible.⁵ This article will use the term 'remedy in equity' rather than 'equitable

⁵ See *Alternative Unlimited, Inc. v. New Baltimore City Bd. of Sch. Comm'rs*, 155 Md. App. 415, 458 (2004) ("Contrasted with that that sweeping and essentially cliched meaning of "equitable" is "equitable" as it more carefully distinguishes an "equitable remedy" from a "legal remedy," each with its own attendant procedures and consequences.") and the Restatement (Third) Of Restitution And Unjust Enrichment § 51(c) ("A statement to the effect that "restitution is equitable" is a harmless platitude so long as "equity" means only "fairness." The same statement becomes mischievous when it is offered as the basis for defining the jurisdiction of courts or agencies, or the kinds of relief they are authorized to administer.").

remedy.' Since it is believed that 'unjust enrichment' denotes a cause in action both at law or in equity as well as a remedy in equity,⁶ the article will employ 'disgorgement' to denote the remedy in equity.

II. Corporate Outlaws

Some of the more notorious outlaws of the old West have been romanticized by folk songs, novels and movies. The corporate outlaws described in this article seem unlikely candidates for such glorification. Our country has plenty of criminals who cheat and steal but these convicted executives are unusual because they were so successful in their legitimate business endeavors that they did not need to steal the additional money to feed their families, to send their children to college or to pay for a lifestyle well beyond the desires of most Americans today. Indeed, the discovery that these defendants suffered from a compulsive gambling addiction would at least tend to explain some of the criminal chaos that many of them seemed to seek out so willingly.

As a point of reference these felons might be compared with modern bank robbers. The average bank robbery in the U.S. in 2011 resulted in a gross loss of less than \$ 10,000 per robbery. The total amount of cash and securities stolen in the 5,086 bank robberies of \$ 38.3 million in 2011⁷ represents less than half of the production budget for 'Public Enemies' of \$102.5 million,⁸ a 2009 movie about John Dillinger, a ruthless murderer and bank robber in the Depression. So when Ian Gittlitz defrauded his company, ICD Publications Inc., of \$1,220,623 in unauthorized advances and fraudulent expense reimbursements,⁹ he committed the equivalent of more than 122 bank robberies.¹⁰

⁶ See generally, Douglas Laycock, *The Scope and Significance of Restitution*, 67 *Tex. L. Rev.* 1277 (1989), Douglas L. Johnson & Neville L. Johnson, *What Happened to Unjust Enrichment in California? The Deterioration of Equity in the California Courts*, 44 *Loy. L.A. L. Rev.* 277 (2010); Doug Rendleman, *When Is Enrichment Unjust? Restitution Visits an Onyx Bathroom*, 36 *Loy. L.A. L. Rev.* 991 (2003); Paul T. Wangerin, *The Strategic Value of Restitutory Remedies*, 75 *Neb. L. Rev.* 255 (1996).

⁷ According to FBI data, the number of bank robberies (at federal insured institutions) decreased from 7,644 in 2003 to 5,086 in 2011. Similarly, the gross amount taken declined from \$ 77.1 to \$ 38.3 million and the average amount taken declined from \$ 10,086 to \$ 7,538. See U. S. Department of Justice, Federal Bureau of Investigation, *Bank Crime Statistics (Federally insured institutions)*

⁸ According to the website at <http://www.the-numbers.com/movie/Public-Enemies>, *Public Enemies* was rated the 254 highest in production budget at \$102,500,000.

⁹ See note 147 *infra*.

¹⁰ Of course, this overlooks the 88 injuries (principally to bank personnel) and 13 deaths (principally to the perpetrators) in 2011.

In contrast to armed bank robbers, these corporate outlaws worked their way into positions of power and influence through their legitimate success. They earned the respect and trust of their shareholders and directors. They did not appear suddenly at corporate headquarters, menacing the board of directors with guns and demanding access to the corporate vault. They were invited into the boardroom where they were delegated control over corporate personnel and large amounts of assets and money. The basis of their authority was the respect and trust that they had legitimately earned over a long period of success. But as disloyal fiduciaries, they breached their duty and betrayed their relationships and that trust on numerous occasions.

Because of the size of the claims and the employers, the four cases are not meant to be representative of a typical case but more of how the combination of remedies can vary. The remedy packages awarded differ but some important similarities stand out despite the difference in company size and date:

The defendants were all successful CEO's, some of whom transformed their industries;

All but one defendant enjoyed annual compensation in excess of one million dollars;

All were found guilty of at least one felony (only one served significant time in jail);

None of them confessed and surrendered to the mercy of the court;

Based on compensating damages awarded, the amount of money stolen per time period amounted to less than 25% of the executive's compensation for the same time period;

Compensation forfeiture contributed a majority of the non-exemplary damages for each one (See Appendix 1); and

Punitive damages were awarded against three of the defendants.

A.Richard Grassgreen: 'You Don't Tug on the Robes of a Judge in Equity'

In 1969 Perry Mendel founded Kinder-Care Inc. ("KC") which grew rapidly to become the largest provider of child care in the U.S. by 1989.¹¹ As the national chain grew and prospered, the company diversified into supporting financial and insurance services as well as related specialty

¹¹ Enstar Group Inc. v. Grassgreen, 812 F. Supp. 1562, 1564 (N. D. Alabama 1993)

retail product lines.¹² Richard Grassgreen helped to establish the company as Mendel's second in command. In the 1980's, Grassgreen' operated as a director of the company and with titles ranging from executive vice president to chief operating officer. In 1989, the company was effectively split into two separate companies: Kinder Care Learning Center Inc. ("KCLC") that owned and operated the day-care operations and Enstar which marketed the ancillary services and specialty retail products.¹³ At the time of that reorganization, Mendel assumed control of KCLC by himself and Grassgreen took control of Enstar, each as Chairman of the Board and CEO.¹⁴

The investment activities that formed the primary source of their liability occurred solely in 1985 and 1986.¹⁵ From 1987 through 1989, their disloyalties were found to be their failure to disclose or volunteer information about the prior investments. In 1990 the disloyalties were expanded to also include misrepresentation and concealment of evidence.¹⁶

Until KC was reorganized in 1989, Grassgreen had exclusive authority over KC's investment operations.¹⁷ In the mid-1980's, Mendel and Grassgreen formed a partnership¹⁸, Megra Partners ("Megra"), that made investments for the personal gain of the two equal partners.¹⁹

In their early days in the 1970's and early 1980's, their investment banker, Mike Milken at the firm of Drexel Burnham Lambert ("Drexel,")²⁰ was instrumental in providing the company with access to outside investment capital to support the company's rapid growth.²¹ As the company's operations grew and blossomed, KC no longer required outside capital as it generated substantial amounts of cash in excess of what was needed to maintain and grow existing operations. Mendel and Grassgreen sought out the help of their investment banker on how to invest the company's surplus cash.²²

¹² Id. at 1565

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Id. at 1566-1568

¹⁶ Ibid.

¹⁷ Id. at 1565

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ In the interest of full disclosure, the author was an investment banker for Drexel from 1975 to 1980 and 1989 to 1990 but never worked on the KC account.

²¹ Id. at 1565 - 1568

²² Id. at 1566

While Kinder Care was growing and prospering in the late '70's and early '80's so was Drexel and Mike Milken.²³ By March of 1985, Drexel was actively involved in financing large corporate mergers, friendly or not, with large amounts of junk bonds.²⁴ Indeed, Drexel's annual conference in Beverly Hills for investors in the takeover craze, the so-called Predators' Balls, was notorious throughout the 1980s.²⁵

Given the conditional nature of making a merger (friendly) or takeover (unfriendly) offer that required shareholder and regulatory approval, the financial facilities for such projects required substantial flexibility. Drexel and other investment bankers therefore provided the putative buyer with pools of short-term, stand-by capital (similar in theory to a line of credit.)²⁶ During such a project, the would-be buyer paid a commitment fee of .75% for a stand-by financing facility. The fee represented payment for the investor's commitment to provide financing if and when the merger proposal succeeded.²⁷

Mendel and Grassgreen's primary breaches of duty related to their arrangement for Megra to receive the stand-by fees but for KC to make the actual investments, when and if required.²⁸ Disloyalty for sure, this practice could be described as self-dealing or fraud but the simplest term is either embezzlement or theft. Megra received fees for which it provided no consideration and for which KC was liable to provide funding.²⁹ In 1985 and 1986, Megra received \$ 920,000 of stand-by fees³⁰ that belonged to KC and that would require \$ 47,000,275 of investment by Kinder Care.³¹ In addition, Megra arranged for KC and its affiliates to invest \$ 51 million more in an arbitrage partnership known as Cohen Feit.³² As a result of KC's investment, Megra was granted a limited partnership interest in the general partner and received payments of \$ 430,731.

²³ Id. at 1565-66

²⁴ Id. at n. 3 ("The bonds were called "junk" because they were considered too risky to be investment quality bonds. While the risk associated with these bonds was significantly higher than other types of investments, the returns were also significantly higher.")

²⁵ For one view of Drexel Burnham Lambert's role in the investment activity in mergers and takeovers at that time See Connie Bruck, *The Predator's Ball* (Simon and Schuster)

²⁶ *Enstar Group Inc.*, 812 F. Supp. at 1565-66.

²⁷ For example, for KC's commitment to invest \$ 10,000,000, Megra would have received a fee of \$ 75,000.

²⁸ *Enstar Group Inc.*, 812 F. Supp. at 1565-66.

²⁹ Id at 1566 ("Kinder-Care money was invested or committed, but instead of Kinder-Care receiving the fees paid in exchange for the investment or commitment, the fees were kept by the individual officers and directors who had committed the investment of their corporation's money.")

³⁰ Id. at n. 10.

³¹ Id. at 1566-67.

³² Id. at 1567

In total, Megra earned \$ 1,350,731 in commitment fees and partnership distributions while KC invested approximately \$ 98 million in takeover securities and a private arbitrage fund. KC received the dividend and interest payments on the takeover securities but it also had to pay for the income taxes on Megra's commitment fees and other partnership income because Megra used KC's tax identification number.³³

Megra also accrued gains from investment opportunities gained from its participation in the Drexel takeover investments. In 1985, Megra was offered the opportunity to purchase warrants in the acquisition vehicle that purchased Storer Communications as an additional return on KC's investment of roughly \$5 million in the related acquisition financing. The warrants were purchased with \$ 15,224 from the Megra account through MacPherson Partners. These warrants earned a total profit of \$ 674,000 which was paid in January and March of 1989 (the "MacPherson Investment."³⁴) In March of 1986, Megra also invested \$165,000 of the commitment fees to purchase the common stock of THL Industries, Inc. which was later sold for a profit of \$ 586,461 (the "THL Investment.")³⁵

Starting sometime in the mid 1980's, a number of accusations were directed at Wall Street and especially at Drexel and Mike Milken relating to securities fraud, insider trading and negligent standards for underwriting junk bonds. Market practices on junk bonds, stand-by investments and takeover financing were also being investigated by Rudy Guiliani, a U.S. Attorney in the Southern District of New York and by other government entities.³⁶

The Board of Directors of Enstar hired special outside counsel in January of 1990 to investigate rumors relating to the MacPherson Investment, alleging that Mendel and Grassgreen had personally retained the warrants that KC should have received for its investment in the Storer Communication takeover.³⁷ Throughout the investigation, Grassgreen denied receiving any commitment fees and failed to disclose any of Megra's activities.³⁸ At a cost of \$ 260,395, that investigation found no wrong-doing and Enstar reimbursed Grassgreen an additional \$ 68,552 for his legal expenses during the investigation.³⁹ However, Mendel and Grassgreen did disgorge

³³ Id. at 1566-67

³⁴ Id. at 1567-68

³⁵ Id. at 1568

³⁶ Id. at 1568

³⁷ Ibid.

³⁸ Ibid.

³⁹ Ibid.

the profit it received in the MacPherson Investment although they retained their interest in the MacPherson entity.⁴⁰

Mendel and Grassgreen continued to 'stonewall' and failed to disclose any additional information until Giuliani's investigation revealed records of the stand-by fees.⁴¹ After about eight to nine months from first learning of the possible scandal, Enstar's board of directors allowed Grassgreen to resign in October of 1990.⁴² On October 19, 1990 Grassgreen also pled guilty to one count of mail fraud relating to the receipt of commitment fees and one of securities fraud in relation to the MacPherson Investment.⁴³ Even after entering into the consent decree, however, Mendel and Grassgreen made no restitution to Enstar for any of the commitment fees.⁴⁴

Enstar's initial complaint was filed against both Mendel and Grassgreen. Subsequently, Mendel settled with Enstar for an additional \$ 4,500,000.⁴⁵ It is also worth noting that by the time of the actual trial, Enstar had filed for bankruptcy and therefore the lawsuit was pursued by either the debtor in possession or a bankruptcy trustee.⁴⁶

Acknowledging that hindsight is more profound than foresight, it is interesting to consider Grassgreen's position at the end of 1990. Around that time, Grassgreen enjoyed a net worth of about \$ 26.9 million⁴⁷ and probably could have settled his liability somewhere between \$ 1.95 million, the eventual amount of compensating damages, and \$ 4.5 million, the settlement for Mendel.⁴⁸ Other than testifying against Drexel and Milken as required under his plea bargain, he would have resolved his criminal and civil liability with plenty of net worth to spare. Whatever calculation Grassgreen did make, it seems unlikely that he took into account possible liability for \$ 5.2 million of forfeited compensation for the prior five years (or punitive damages

⁴⁰ Ibid.

⁴¹ Id. at 1568 ("Also, Megra's records relating to the Drexel accounts which reflected the payment of commitment fees disappeared and, therefore, special counsel did not see them during the investigation. Grassgreen's misrepresentations, along with the disappearance from Megra's records of the Drexel documents, concealed the payment of commitment fees until records showing the fees were discovered in Drexel's papers by the U.S. Attorney in October, 1990 during his investigation of Drexel.")

⁴² Id. at 1568

⁴³ Id. at 1569

⁴⁴ Id. at n. 10 (reconciling each component of the \$ 1,947,549.69 of compensating damages without any adjustment for any payments by Grassgreen.)

⁴⁵ Id. at 1569

⁴⁶ Id. at 1574

⁴⁷ Id. at 1580

⁴⁸ Id. at n10

of ten million more.) Instead his choice was to stonewall Enstar's civil claims which resulted in a net civil award for \$15 million⁴⁹ in addition to the costs of defending the civil claim.

Even though Grassgreen had already made some reimbursements and plead guilty to two felonies, Grassgreen entered the civil trial unrepentant and in denial of his disloyalty. The trial judge specifically refers to Grassgreen's attempt to hide or shield his assets⁵⁰ and makes references to testimony that the jury or he did not find credible.⁵¹ In reading the opinion, it is clear that the judge was concerned with Grassgreen's egregious disloyalty and regarded him as an example of the need to reinforce integrity in officers and directors of corporate business.⁵²

The trial was conducted in two parts. In the main case the jury found Grassgreen liable for breach of fiduciary duty and awarded Enstar compensating damages of \$ 1,947,549.69⁵³ (which were largely uncontested in amount) and punitive damages of \$ 18,000,000.⁵⁴ Thereafter, the jury was dismissed and the parties contested the issues of compensation forfeiture, adjustments to the compensating damages and the reasonableness of the jury's punitive damages award.

The Grassgreen case is a strong example of the unique relief sometimes achieved with remedies in equity. Certainly forfeiture of compensation is a uniquely advantageous remedy for the plaintiff as it is mutually exclusive with no other remedy and need not relate to any damage or loss of the principal.⁵⁵ However, in this case the other remedies in equity and the process of measuring remedies in equity also increased the size of the total package of remedies. For a claim of breach of fiduciary duty at law, damages are measured as of the date of the tort. Compensating damages would be limited to the lost commitment fees and the costs of investigation.

⁴⁹ Id. at 1584

⁵⁰ See note 67 *infra* and accompanying text.

⁵¹ For example, see notes 4,5,7 and 8 in the opinion.

⁵² Id. at 1570 ("For this country's economic system to work in the area of corporate investment, the investor must be assured that the corporation's officers and directors will put the interests of the corporation first and that their decisions will not be clouded in any way by competing personal interests. If an officer and director violates that trust which is placed in him, and breaks the rules which govern his position of trust, the law requires that he must answer for that breach.")

⁵³ Id. at n. 10.

⁵⁴ Id. at 1569

⁵⁵ Id. at 1574.

The measure of a remedy in equity, however, is based on an accounting in equity which is based on different evidentiary principles and presumptions which were developed over the last 500 years to process claims against trusts and fiduciaries. First, the measure of a remedy in equity is based on ex post data, as current as the date of trial. Therefore, the measure of the damages should include any subsequent gains that the defendant accrued with the principal's money and its proceeds.

For remedies in equity based on accounting in equity, the ex post gains of some investments do not have to be offset by the losses of the other investments that declined in value between the date of the tort and the date of trial. Accounting in equity allows the claimant to pick which investments are to be valued at the date of the tort and which on the date of trial. The principal is entitled to treat each investment separately and accept or reject the actual results of each separate transaction.⁵⁶ Effectively each investment is treated as a separate count and the principal is free to choose between remedies in equity or remedies at law for each one.⁵⁷

Without any discussion of adequate remedy or irreparable injury,⁵⁸ the Court effectively granted the remedy in equity of constructive trust against Megra and its holdings of the commitment fees and other special investments that Megra purchased with the proceeds of the commitment fees.⁵⁹ The effect of a constructive trust is two-fold: it provides a lien for the principal's claim and it requires a formal process of accounting in equity that allows the principal to trace the proceeds of its lost assets and funds to recognize any subsequent enhancements in value. Such an accounting also credits the principal for any interim dividends, splits or exchanges that represented increases in value.

To similar effect, the Court granted the remedy in equity of specific restitution for Megra's interest in MacPherson Partners. Specific restitution transfers possession of an asset to the claimant, enabling the principal to capture any income earned or appreciation in the asset's value subsequent to when the defendant wrongly gained possession.⁶⁰ Similar to a constructive

⁵⁶ Id at 1574

⁵⁷ See Restatement (Third) of Restitution and Unjust Enrichment § 51(5)(b) (2011) ("A conscious wrongdoer or a defaulting fiduciary who makes unauthorized investments of the claimant's assets is accountable for profits and liable for losses.") and Restatement (Second) of Trusts § 213 (1959). See also See George P. Roach, Unjust Enrichment in Texas: Is It a Floor Wax or a Dessert Topping?, 65 Baylor L. Rev. 153, 161-62 (2013)(discussing the rationale and wide-spread application for the anti-netting rule.)

⁵⁸ See section IV B about adequate remedy and irreparable injury

⁵⁹ Enstar Group Inc., 812 F. Supp. at 1575.

⁶⁰ See note 204.

trust, specific restitution also generally 'primes' any lien subsequently placed on the asset after the defendant gained possession.

The opinion provides a detailed analysis of Grassgreen's activities and management responsibilities while he committed his disloyal acts to establish a pervasive pattern of disloyalty and causation.⁶¹ Grassgreen's actions were also found to be highly egregious.⁶² The possibility of apportioning Grassgreen's compensation, forfeiting less than 100% of the compensation actually paid, was discussed in Judge Albritton's opinion as a theoretical possibility. He acknowledged that a judge in equity enjoys substantial discretion and that partial forfeiture was possible but inappropriate for Grassgreen's case, emphasizing the flagrant disloyalty.⁶³

The opinion thoroughly analyses the jury's award of punitive damages.⁶⁴ The judge reviewed a number of factors and issues but his conclusion on reducing the punitive damages from \$ 18 to \$ 10 million was not transparent. He effectively concluded that \$ 10 million in punitive damages would be a more reasonable award than \$ 18 million. One interesting factor that he considered was the fact that Grassgreen was not expected to serve much time in jail or prison.⁶⁵

One of the issues that must be reviewed in a punitive damage award is the defendant's net worth and the defendant's ability to pay the punitive damages as the judge acknowledged that exemplary damages in Alabama are intended to punish but not destroy the defendant.⁶⁶ The judge took exception to Grassgreen's testimony about how his net worth declined so precipitously from \$ 26.9 million in June of 1990 to \$ 3.0 million at trial in 1993. His review noted that Grassgreen's inventory of assets at trial did not include an asset valued at \$ 20 million in 1990:

⁶¹ Id. at 1571-73

⁶² Id. at 1579 ("Grassgreen's conduct was truly reprehensible. He evinced an arrogant and callous disregard for his duties as president and director of his corporation. Rather than giving his corporation the benefit of commitment fees and lucrative investment opportunities, or of honestly telling his directors about these dealings and seeking their approval, he secretly took the money for himself.")

⁶³ Id. at 1574

⁶⁴ Id. at 1576-1582

⁶⁵ Id. at 1581 ("The Defendant has argued that the light sentence he received is evidence that his conduct was not a serious offense. This court disagrees and attributes the lightness of the sentence to the fact that the New York court was rewarding Grassgreen for helping to convict Milken, and also to the fact that the New York court did not have the benefit of all of the evidence which is before this court showing the egregiousness of Grassgreen's breach of trust.")

⁶⁶ Id at 1580.

The Plaintiff presented evidence that tended to show that, through a series of transactions involving Grassgreen's wife and related companies, this stock has, in effect, been converted into an investment now held in the name of Grassgreen's wife which will provide periodic payments to Mr. and Mrs. Grassgreen over the next 14 years in excess of \$ 19,000,000. Without analyzing the effect of those transactions on creditors of Grassgreen, the court finds that, at the very least, this evidence shows efforts on Grassgreen's part to shield assets. The court does not consider Grassgreen's testimony concerning his financial position to be credible.⁶⁷

As a result, Grassgreen possibly learned the first of two key reasons why you must not try to deceive a federal judge that sits in equity: you are more likely to experience justice rather than mercy in his holdings. Thus the exemplary damages were only reduced from eighteen to ten million which was likely to be necessary to survive review from the Eleventh Circuit.⁶⁸ The final judgment of \$ 15,017,698 reflects a credit of \$3,262,765 for Mendel's settlement payments of \$4,798,183.13.⁶⁹

No public record has been found of whether Enstar succeeded in fully collecting the judgment. It seems likely, however, that in that process Grassgreen may have learned the second key reason not to annoy a federal judge sitting in equity is that his orders are issued under his *in personam* authority as a judge sitting in equity.⁷⁰ In similar circumstances some judges have sent a defendant to jail for failing to satisfy the order.⁷¹

Loyalty, ethics and criminal issues aside, the takeover investments seemed to produce only a small return for the risks involved. KC had to invest \$ 47 million to generate commitment fees of \$ 920,000 for Megra and KC had to invest \$ 51 million to yield \$ 460,000 of partner distributions for Megra. Given the acknowledged expertise and experience of Mendel and

⁶⁷ Ibid.

⁶⁸ Compensating damages amounted to only \$ 1.95 million; therefore if punitive damages amounted to \$ 18 million, the ratio of punitive to compensating damages would have been 9.2. See note 184 *infra* for further discussion of ratios of punitive to actual damages.

⁶⁹ Id. at 1584

⁷⁰ See 1 Dan B. Dobbs, *Law of Remedies*, § 2.2 (2d ed. 1993) ("The command was personal and there were echoes in it of the king's political power of an earlier era. When he disobeyed, there was something like *lese majesty*, and he was clamped in irons as punishment for his disobedience."); see also Langdell, *supra* note 4, at 117.

⁷¹ See *Pierce v. Vision Inv., Inc.*, 779 F.2d 302, 309 (5th Cir. 1986) ("Because the court's order in the present case is an equitable decree designed to protect the public and to permit effective enforcement of the Interstate Land Sales Full Disclosure Act, a judgment of contempt designed to enforce that order is entirely appropriate.) and C.C. Langdell, *A Brief Survey of Equity Jurisdiction*, 1 *Harv. Law L. Rev.* 111, 117 (1887) ("[I]f a court of equity decides that the defendant in a suit ought to pay money or deliver property to the plaintiff . . . it commands the defendant personally to pay the money or to deliver possession of the property, and punishes him by imprisonment if he refuse or neglect to do it.")

Grassgreen in the childcare industry, it likely that they could have found some better use for \$ 98 million of investment capital than buying takeover junk bonds. An alternative investment in operations, for example, might have helped Enstar avoid bankruptcy by 1993.

B. William Aramony, the 'Richard Nixon or Pete Rose of the Nonprofit Sector'⁷²

The Aramony case is notable for a couple of key issues. William Aramony was a 60 year old married man who pursued multiple affairs at the same time with women in his offices and stole money from the national charity that he made famous. Even though there was substantial evidence of his disloyalties (including his conviction for twenty counts of criminal fraud based on the testimony of his personal staff) his employer was only awarded compensating damages for a small portion of the expenses of conducting an internal investigation. Perhaps not surprising for a charity, the board of directors suffered difficulties and indecision in reacting to the Aramony scandal and in seeking reimbursement for what proved to be serious losses from declining contributions.

Under the leadership of William Aramony, United Way grew to become the nation's largest community funder. During his administration, for example, United Way formed an alliance with the National Football League in 1975.⁷³ In 1991, the last full year before the scandal broke, the United Way consisted of approximately 2100 local groups that raised almost \$ 3.2 billion annually and which voluntarily pledged about \$ 24 million to the United Way 'headquarters' or United Way America ("UWA") which provides technical support and services to the local groups.⁷⁴

His salary for the last full year was \$ 390,000.⁷⁵ He 'supplemented' that income illicitly in two ways: forming independent companies (off balance sheet) that 'served' the employer company⁷⁶ and extensively abusing UWA's expense and reimbursement system.

He was a colorful public figure that attracted media attention. According to various news reports, Aramony's problems in 1991 actually began in 1986 when he met Lisa Villfors Thomas, age 22, on an airplane. They became acquainted and he offered her a job at his headquarters

⁷² TheNonProfitTimes, Old Battles and New Challenges (April 1, 2002)("There are some names within areas of American culture that conjure up conflicting emotions. In politics, there's Richard Nixon. In baseball, it's Pete Rose. For the nonprofit sector, it's William Aramony.")

⁷³ Ibid.

⁷⁴ William Aramony v. United Way America, 28 F. Supp. 2d 147, 165-66 (S.D.N.Y. 1998) rev'd on other grounds

⁷⁵ Id. at 156

⁷⁶ Id. at 156-57

as they started their affair.⁷⁷ That relationship, however, ended when Aramony met Lisa's younger sister, Lori Villfors, age 17 and recent high school graduate.⁷⁸ Thus began the spectacle in New York of the CEO of United Way, age 59, being sighted in public in the company of an attractive young lady who was not even old enough to be his 'niece.'⁷⁹ According to the 71 count indictment, Aramony spent UWA's money on maintaining Lori in a lavish lifestyle in mid-town Manhattan.⁸⁰ Aramony's explanation was disingenuity disguised as altruism "[Lori] comes from a poverty background. I don't want her to slip back into it."⁸¹

An anonymous letter to the chairman of UWA's executive committee on UWA letterhead, demanding Aramony's removal for financial irregularities and other misbehavior at his office, allegedly initiated Aramony's confrontation with UWA. Adverse news reports and media inquiries accelerated the Board's investigation out of concern about the impact of a public scandal on donations to the local groups and voluntary contributions from the local groups to the headquarters budget.⁸²

For four years, the only action that UWA took against Aramony was self help. UWA fired Aramony in 1992 (after 22 years as the CEO) and canceled his employment contract, claiming that his contract and his retirement plans were void. By this time, he and UWA were being investigated by a variety of city, state and federal government agencies.⁸³

While the criminal proceedings continued,⁸⁴ Aramony filed a suit in 1996 against the UWA to collect compensation under his contract and, more importantly, to establish his retirement benefits. UWA counterclaimed against Aramony for fraud and breach of fiduciary duty. The

⁷⁷ New York Daily News, March 10, 1995, Laurie C. Merrill, 'Ex-Charity Chief Wooed Her Sister'

⁷⁸ Ibid.

⁷⁹ His obituary indicates that William and his wife, Bebe, agreed to separate in 1988 and finalized their divorce in 1991. See New York Times, November 13, 2011, Robert D. McFadden, 'William Aramony, United Way Leader Who Was Jailed For Fraud, Dies At 84.' Other newspaper articles report that between 1986 and 1991, Aramony carried on affairs with Lori Villfors as well as at least two other female employees at UWA.' New York Daily News, March 10, 1995, Laurie C. Merrill, 'Ex-Charity Chief Wooed Her Kid Sis'; Time Magazine, October 3, 1994, 'Charitable Seductions'; Time Magazine, June 24, 2001, Michael Duffy, 'Charity Begins at Home';

⁸⁰ New York Daily News, March 10, 1995, Laurie C. Merrill, 'Ex-Charity Chief Wooed Her Kid Sis'

⁸¹ Time Magazine, October 3, 1994, 'Charitable Seductions'

⁸² E.g. see Washington Post, February 28, 1992, Charles E. Shepard, "United Way Head Resigns Over Spending Habits."

⁸³ William Aramony v. United Way America, 28 F. Supp. 2d 147, 163-64 (S.D.N.Y. 1998) aff'd in part and rev'd in part on other grounds, Aramony v. United Way Replacement Benefit Plan, 191 F.3d 140 (2d Cir. 1999)

⁸⁴ Id. at 165-66. (Aramony was convicted of more than 20 counts of fraud, mail fraud, tax fraud and other related crimes and he was sentenced to seven years of prison.)

delay in UWA's assertion of its claims would prove to diminish the eventual award of forfeiture and other damages because of the statute of limitations.

It might seem reasonable to expect an easier civil law suit if the defendant has been convicted on 15 criminal charges⁸⁵ that relate to your civil claims but UWA was somewhat disappointed with the court's response to their estoppel motion. The judge generally agreed that Aramony should be estopped from denying the acts for which he was convicted but he limited the estoppel to only those specific criminal acts and not other acts related to civil liability.⁸⁶ The facts proven were damning but limited in dollar amount and still subject to the possibility that the Board may have waived some or all of Aramony's liability during their negotiations. The only direct evidence of Aramony's disloyalty was the estoppel effect of his criminal convictions and the testimony of a former secretary and an assistant who described the process by which Aramony would dictate his expense reports daily over the phone, a process that the trial judge later called 'creative coding.'⁸⁷

United Way's claim for compensating damages was limited by two further issues. Damages were constrained by the seven year statute of limitations provided under New York law for victims of crime⁸⁸ to a remaining period from September of 1989 through December of 1991.⁸⁹ Under that statute, however, UWA's recovery was further limited to that conduct for which Aramony was convicted.⁹⁰ The second issue was one of implied waiver. The Court held that UWA had effectively waived many of Aramony's key criminal acts in the Board's attempts to reconcile with Aramony.

The actions taken by the board of directors suggest an indecisive group. For the year prior to his departure, Aramony had a series of increasingly confrontational meetings with the Board of Directors. The Board authorized an extensive investigation by outside counsel, special investigators, accountants and public relations consultants. Before the board eventually fired him, the board passed resolutions of confidence in Aramony twice and once refused to accept his resignation although the Board was only partially informed of the true extent of his disloyalties. Aramony's claim that UWA waived his liability for his misdeeds, however, proved

⁸⁵ Id at 158-59 (Holding as to the estoppel effect of Aramony's six mail fraud convictions, one wire fraud conviction and his conviction on eight counts of interstate transportation of fraudulently obtained property.)

⁸⁶ William Aramony v. United Way America, 28 F. Supp. 2d 147, 165-66 (S.D.N.Y. 1998) aff'd in part and rev'd in part on other grounds, Aramony v. United Way Replacement Benefit Plan, 191 F.3d 140 (2d Cir. 1999)

⁸⁷ Id. at 159 ("Such "creative coding" occurred on a monthly basis from 1982 through at least September 1989.")

⁸⁸ N.Y. C.P.L.R. § 213-b

⁸⁹ William Aramony, 28 F. Supp. 2d at 176.

⁹⁰ Id. at n29

successful in eliminating his liability for some of more important actions for which he was convicted.

The Aramony case is also noteworthy for three other issues. First, the court did not deny the possibility of awarding consequential damages for the subsequent decline in contributions to the local United Way groups or the group's pledges of support for UWA but Judge Scheindlin held that UWA's claim for lost contributions,⁹¹ ranging from \$12 to \$ 32 million, was excessively speculative.⁹² In light of the judge's ruling on estoppel, UWA had to prove how Aramony's criminal actions caused the decline in contributions to the local groups and the decline in the groups' voluntary pledges to UWA.⁹³ The expert testimony was insufficient to find that Aramony's criminal activities and his creative coding were a substantial cause for the decline in contributions from the local groups.⁹⁴

Second, UWA pursued a wide ranging investigation into Aramony's activities and their likely impact on United Way and UWA's public image. UWA asserted a claim for the direct costs of the investigation for \$ 2,318,164⁹⁵ which were approved only in the amount of \$ 232,138⁹⁶ after applying the substantial factor causation standard.⁹⁷ The professional invoices were not properly detailed or itemized by issue to ensure a fair allocation process or one tied to the limited estoppel effect. Furthermore, some of the items claimed were not in sync with the estoppel order. For example, United Way claimed more than \$ 127,000 in consequential damages to pay for a headhunter agency to replace Aramony. The court allowed none of the

⁹¹ In retrospect, one observer has concluded that the scandal had a significant impact. See *TheNonProfitTimes*, *Old Battles and New Challenges* (April 1,2002)(" Several United Ways disaffiliated themselves with the national office and filed name changes. And, local UWs still respond to questions about the scandal at the Alexandria, Va., office. The immediate decline of donations to United Ways in 1992 and 1993 followed two years of slowing campaigns amid the economic doldrums of the early 1990s. UW agencies saw smaller allocations.")

⁹² *Id.* at 153

⁹³ *Id.* at 177 ("Even assuming that UWA reduced its percentage in response to the withholding of dues in early 1992, Aramony's criminal conduct was not a "substantial factor" in causing that reduction. The press reports in early 1992 focused on Aramony's salary, his "perks" (first-class travel, use of the Concorde and a chauffeured car, and a Super Bowl trip), UWA's relationship with its spin-offs, and Aramony's hiring of friends and relatives. The only criminal conduct which was even discussed in the press in early 1992 was the purchase of the Florida condominium.")

⁹⁴ *Id.* at 177 (" In an action for breach of fiduciary duty, a party may recover damages without proving that his injury was foreseeable or anticipated; he need only show that the breach was a substantial factor in causing the injury.")

⁹⁵ *Id.* at 176, 179-181 (Detailing UWA's claim for an additional \$ 1,935,699 of indirect, consequential expenses which were denied.)

⁹⁶ *Id.* at 179-81

⁹⁷ *Id.* at 177. The Second Circuit later noted, without ruling, that the substantial factor test may be inappropriate. *Aramony v. United Way Replacement Benefit Plan*, 191 F.3d 140, 154 (2d Cir. 1999) citing *LNC Invs., Inc. v. First Fidelity Bank, N.A. New Jersey*, 173 F.3d 454, 465 (2d Cir. 1999) (rejecting use of "substantial factor" analysis, in favor of proximate causation, where remedy sought is compensatory damages rather than restitution).

claim because UWA failed to prove how much more expensive it was to replace Aramony because of his criminal activities. In total, all compensating and consequential damages other than forfeiture amounted to only \$ 232,138 (including the \$ 85,400 of investigation and other consequential expenses) plus pre-judgment interest of \$125,751 which based solely on the partial reimbursement for investigation expenses.

The third issue relates to the forfeitability of retirement benefits and a dispute over dueling plans for retirement benefits. UWA contended that a draft of the defined benefit plan was the applicable plan even though it was never executed. That draft was important because its felony forfeiture provision provided that the retirement benefits were non-forfeitable unless the beneficiary were convicted for the felony commission of fraud or embezzlement.⁹⁸ Aramony prevailed in his assertion that the executed plan controlled and that the plan was therefore non-forfeitable.⁹⁹ However, the separate 'Top Hat' plan had no provision relating to forfeitability and was therefore subject to forfeiture which increased Aramony's loss by about \$ 300,000.¹⁰⁰ For this round of the litigation, UWA was found liable for Aramony's retirement benefits in the amount of \$ 3,221,057 plus prejudgment interest of \$ 1,177,121.¹⁰¹ There were a series of subsequent opinions as the Second Circuit issued two subsequent opinions that reversed the Southern District on parts of this issue although Aramony did keep his main retirement benefits.¹⁰²

Subject to the advice of an ERISA lawyer, the key issue is not the mechanics of defined benefit plans nor ERISA law but the fact that a non-forfeitability clause could have saved or preserved the 'top hat' plans which was not protected by ERISA. Only a few cases relating to the forfeitability of 'top hat' plans have been found but they both confirm this inference based on dicta.¹⁰³ Aside from benefit plans, one other opinion has been found that suggests that a prior

⁹⁸ Id. at 144

⁹⁹ Id. at 153-155

¹⁰⁰ Id. at 168

¹⁰¹ Id. at 171,175

¹⁰² *William Aramony v. United Way of America*, 254 F.3d 403, 405 (2d Cir. 2000) ("We affirmed the judgment except insofar as it held that United Way was estopped from denying that Aramony was entitled to certain pension benefits under a Replacement Benefit Plan to replace benefits lost because of the 1986 enactment of Section 401(a)(17) of the Internal Revenue Code, which placed a cap on the annual compensation that can be taken into account by a qualified pension plan in calculating the benefits due to each employee. See *Aramony v. United Way Replacement Benefit Plan*, 191 F.3d 140 (2d Cir. 1999) ("Aramony II"). On remand, the district court ruled that Aramony was entitled under the terms of the Replacement Benefits Plan to the disputed replacement benefits. See *Aramony v. United Way of America*, 86 F. Supp. 2d 199 (S.D.N.Y. 2000) ("Aramony III"). We reverse and remand for entry of judgment in favor of United Way.")

¹⁰³ *Tyco Tyco Int'l, Ltd. v. Kozlowski*, 756 F. Supp. 2d 553, 565 (S.D.N.Y. December 1, 2010) citing *Bigda v. Fischbach Corp.*, 898 F. Supp. 1004, 1016 (S.D.N.Y. 1995) (" Under federal common law, benefits accrued in top hat plans are assumed to be forfeitable unless otherwise agreed to by the parties to the contract.") and *Foley v. Am. Elec.*

contractual agreement can trump forfeiture.¹⁰⁴ It remains to be seen whether 'non-forfeitability' clauses will be upheld outside of ERISA plans. If so, it seems inevitable that a new CEO employment contract will test public policy by claiming that all compensation will be agreed to be non-forfeitable, regardless of the employee's subsequent actions.

The amount of compensation to be forfeited was not in doubt and not discussed at length.¹⁰⁵ Aramony's compensation was held forfeit from September 1989 until December of 1991 which was the period of his disloyalty as abridged by the statute of limitations. The sum of forfeited compensation (\$ 951,250), pre-judgment interest (\$ 662,805) and the value of the forfeited top-hat plan of \$ 300,000 or \$ 1,914,055 amounts to 80% of the total award and 535% of compensating damages (\$ 232,138 plus prejudgment interest of \$125,751).¹⁰⁶

Judge Scheindlin's opinion never clearly reconciles the damage numbers sufficiently to openly state that Aramony was not held liable for any of UWA's losses from creative coding or self-dealing.¹⁰⁷ Damages consisted entirely of forfeited compensation and a small portion of UWA's investigation expenses plus prejudgment interest. The judge held that UWA had adequately proven Aramony's disloyalty and had breached his fiduciary duty sufficiently to warrant full compensation forfeiture but no other damages were approved.

In considering punitive damages, the federal judge made some 'hard' statements about Aramony stealing from a public charity and the egregiousness of his actions but she assessed punitive damages of only \$50,000. Judge Scheindlin reasoned that punitive damages are intended to punish and deter. She concluded that Aramony's criminal sentence of a prison term of 78 months (at age 68) and a fine of \$ 300,000 was sufficient punishment. In recognition

Power, 425 F. Supp. 2d 863, 871 (S.D. Ohio 2006) ("As to the issue of forfeiture, courts have held that if a top-hat plan does not contain a non-forfeiture agreement, then an employer may withhold that portion of benefit plan payment that accrued during periods of employee disloyalty.")

¹⁰⁴ G.K. Alan Assoc., Inc. v. Lazzari, 44 A.D.3d 95, 102-103 840 N.Y.S.2d 378 (N.Y. App. Div. 2d Dep't 2007) ("Here, the 'surrounding circumstances' include the facts that the stock purchase and consulting agreements were both undisputedly executed on the same day and that the terms of the consulting agreement include Lazzari's waiver of any defense to his obligation to make payments under the agreement on the basis of Alan's failure to provide the consulting services required of it.")

¹⁰⁵ Id. at 171 (Judge Scheindlin refers to compensation forfeiture as the 'federal common law of forfeiture, which is derived from the consensus approach of state courts, employees cannot recover non-vested pension benefits that accrued during periods of disloyalty.")

¹⁰⁶ Id. at 185

¹⁰⁷ Aramony v. United Way Replacement Benefit Plan, 191 F.3d 140, 147 (2d Cir. 1999)(detailing amounts pled and awarded for damages).

of United Way's consequential loss of goodwill, he awarded a token amount of punitive damages of \$ 50,000.¹⁰⁸

Actually, Aramony's punitive damages were effectively greater than \$50,000. This is the only case discussed in this section that awarded prejudgment interest on the forfeited compensation. The judge held that New York law provided for prejudgment interest for breach of fiduciary duty at the discretion of the trial judge. She stated that he opted to award the \$ 662,805 of prejudgment interest to compensate UWA for some of the damage that could not be quantified.¹⁰⁹

Aramony was released in 2002 after serving more than six years of his 78 month sentence. He married within the first year of his release and is reported to have been active in the promotion of mutual understanding in the Middle East¹¹⁰ until his death in 2011 at the age of 84. Indefatigable!

C.Lars Bildman: "He Treated His Company Like a Personal Checkbook and His Sexual Fiefdom"¹¹¹

Bildman's former employer and the plaintiff for breach of fiduciary duty, Astra USA Inc. ("Astra"), also discovered that realizing a damages award against a convicted fraudfeasor can be difficult despite apparent evidence of about \$ 14 million of losses or damage.¹¹² Despite the evidence that Bildman wasted at least \$ 3 million of Astra funds¹¹³ and was responsible for a public scandal that required more than \$ 905,080 in investigation expenses,¹¹⁴ Astra was awarded only \$ 1,040,812 in compensating damages. The award of \$ 6.8 million for compensation forfeiture by the Massachusetts Supreme Court,¹¹⁵ applying New York rather than Massachusetts law, therefore proved instrumental in providing substantial

¹⁰⁸ William Aramony, 28 F. Supp. 2d at 184. ("The wanton and reckless nature of his misconduct exposed the UWA to contempt and ridicule, and angered its most ardent supporters. The harm done to the United Way cannot be quantified in dollars and cents. Thus, I will impose a token punitive damage award to be sure that those who abuse the public, on whose behalf they supposedly work, are punished and that others in that position are deterred.")

¹⁰⁹ For other case that awarded prejudgment interest to compensation forfeiture see V.I.M. Recyclers, L.P. v. Magner, 2005 U.S. Dist. LEXIS 47961, *58 (N.D. Ill. July 21, 2005); Dernick Res., Inc. v. Wilstein, 2015 Tex. App. LEXIS 6684, *47 (Tex. App. Houston 1st Dist. June 30, 2015) and McCullough v. Scarbrough, Medlin & Assocs., Inc., 435 S.W.3d 871, 884 (Tex. App.—Dallas 2014, pet. denied)

¹¹⁰ New York Times, November 13, 2011, Robert D. MacFadden, "William Aramony, United Way Leader Who Was Jailed For Fraud, Dies at 84"

¹¹¹ See note 135 infra.

¹¹² See notes 120 and 136 infra and accompanying text.

¹¹³ See note 126 infra and accompanying text

¹¹⁴ See note 136 infra and accompanying text.

¹¹⁵ Astra USA, Inc. v. Bildman, 455 Mass. 116, 146 (2009)

reimbursement. In the last year of his employment, Bildman was paid an annual salary of \$944,490.50 in addition to a supplemental stock grant valued at \$ 203,691.¹¹⁶

Lars Bildman started up Astra, the U.S. sales operation for a Swedish pharmaceutical company, Astra AB. He built up Astra to a 500 person organization by focusing on the market niche of prescribing doctors.¹¹⁷ His marketing and organizational expertise was countervailed by his pervasive practice of expense fraud as well as participating in and enforcing an office environment that facilitated sexual predation and harassment for more than ten years. Eventually twelve women claimed that they had been harassed by Bildman¹¹⁸ or some other executive and evidence was uncovered that over a ten year period Bildman (a married man) had paid or authorized payments of hush money to at least five women (departing victims or witnesses) that totaled more than \$ 270,000. Four of the payments related to his victims, including his former secretary.¹¹⁹ As a result of the subsequent EEOC investigation, Astra entered into a consent decree that provided a fund of \$ 9,850,000 to compensate the victims.¹²⁰

The report of an impending cover story article in Business Week on sexual harassment at Astra precipitated Bildman's confrontation with Astra AB. Bildman first learned of the tentative Business Week article in December of 1995 and immediately mobilized a task force of outside attorneys and internal executives to investigate the leaks of information from Astra to Business Week.¹²¹ From December of 1995 through the following April, Bildman resisted internal inquiries and investigations with denials and he orchestrated a campaign in which he ordered female Astra employees to write letters of support for him to Astra AB.¹²²

Despite Bildman's best efforts to the contrary, rumors of the article finally reached Astra AB leadership and on April 28, 1996 Bildman was suspended with pay after a preliminary internal investigation.¹²³ Astra AB thereafter retained outside counsel to conduct a more thorough

¹¹⁶ Id at n8

¹¹⁷ Id. at 120.

¹¹⁸ Id. at 124

¹¹⁹ Id. at 120

¹²⁰ The trial judge rejected the Company's attempt to include the amount of the consent decree as compensating or consequential damages. She points out that Bildman was not present or represented during the EEOC investigation. See *Astra USA, Inc. v. Bildman*, 2000 Mass. Super. LEXIS 704, *13, 13 Mass. L. Rep. 686 (Mass. Super. Ct. 2000) ("Astra's consent decree with the EEOC focused on its own sexual harassment policies and practices, and the underlying case related to the hostile work environment created by several individuals connected with Astra, not Bildman alone.")

¹²¹ Id. at 121 ("The task force was not set up to investigate the merits of the sexual harassment claims but rather to determine Business Week's sources of information and to control the flow of information to Business Week and Astra AB.")

¹²² Id. at n11

¹²³ Id. at 122.

investigation which Bildman resisted and refused to assist with any interviews. Against Astra AB's specific request, he and a couple of close associates also conducted a campaign of contacting Astra employees to request or threaten them to deny any knowledge of Bildman's sexual harassment. Astra also presented evidence at the trial that Bildman's group destroyed documents and erased computer hard drives.¹²⁴

On June 25, 1966 Bildman was fired after results from the second internal investigation were presented to Astra AB.¹²⁵ The internal investigation revealed that more than two million of company funds had been spent on Bildman's personal activities and more than one million on falsified expense reimbursements.¹²⁶ The results of the internal report suggested some sexual harassment but nothing comparable that reported in the Business Week cover article in May of 1966, "Abuse of power: The astonishing tale of sexual harassment at Astra USA."¹²⁷

The magazine article not only eliminated any chance for Astra to resolve its issues with Bildman in a private manner but it also attracted the attention of various governmental agencies such as the EEOC and the IRS. In March of 1997, Bildman was indicted by a Federal grand jury for various forms of fraud. In January, 1998, he pled guilty to three counts of willfully filing false Federal tax returns. By plea agreement, the remaining counts were dismissed, including counts charging Bildman with defrauding Astra.¹²⁸

In January of 2002, a civil trial commenced that endured for seven weeks. The jury awarded \$875,512 in compensating damages for fraud and conversion and \$ 1,040,812 for wasting corporate assets. However, the jury also found that the two awards overlapped and thus only the larger sum was actually awarded. The jury found that Bildman engaged in sexual harassment but no separate damages were awarded.¹²⁹ The jury also found that Astra did not breach the employment agreement by terminating Bildman or his participation in the profit sharing plan.¹³⁰

¹²⁴ Id. at 123

¹²⁵ Id. at 124-25

¹²⁶ Id. at n13

¹²⁷ Id. at 124

¹²⁸ Id. at n15.

¹²⁹ *Astra USA, Inc. v. Bildman*, 2006 Mass. Super. LEXIS 114, *1-2 20 Mass. L. Rep. 581 (Mass. Super. Ct. 2006) ("Further, the jury found that Bildman breached his fiduciary duty to Astra by making affirmative misrepresentations while he was its President and CEO, failing to disclose material information he had a duty to disclose, and improperly using Astra funds.... The jury also found that Bildman engaged in sexual harassment, violated Astra's sexual harassment policy, and retaliated against one or more Astra employees who exercised their right to make a complaint under Astra's sexual harassment policy.")

¹³⁰ *Astra USA, Inc. v. Bildman*, 455 Mass. 116, 126 (2009)

Both the trial court and the state supreme court ruled against including any part of Astra's investigatory expenses of \$ 905,080 as compensating damages. The supreme court acknowledged the eligibility of such expenses for compensation but concluded that Astra's efforts failed to prove that Bildman's actions were a substantial factor in causing the investigatory expenses.¹³¹

The trial judge correctly held that New York law controlled on the issue of compensation forfeiture as Astra was incorporated in New York.¹³² (The state supreme court specifically noted that Astra was not suing Bildman under the employment agreement which provided that Massachusetts law controlled.)¹³³ Thereafter, she erred because even though she found that New York law controlled, she still effectively applied Massachusetts law on compensation forfeiture.

The supreme court held that New York law largely requires full forfeiture for cases in which the defendant commits repeated acts of disloyalty.¹³⁴ Even if there were some flexibility to this standard, the case facts warranted full forfeiture because of Bildman's egregious behavior:

The evidence heard by the jury was overwhelming that from 1991 through 1996, Bildman used Astra as his personal checkbook and his sexual fiefdom, in the process driving away employees, creating a corrosive corporate atmosphere, causing Astra actual loss, and leading to months of bad publicity about the company. We agree with Astra that, as a matter of law, even under the more lenient substantial and pervasive standards of forfeiture, see text accompanying note 23, *supra*, Bildman's breaches of fiduciary duty mandate equitable forfeiture of his compensation during the period of his disloyalty.¹³⁵

¹³¹ *Id.* at 137-138 and *Astra USA, Inc. v. Bildman*, 455 Mass. 116, 138-39 (2000)(stating that the substantial factor standard is insufficient to justify causation.) See also note 120 *infra* shows that in a prior opinion, the trial court judge rejected the inclusion of payment for the consent decree escrow fund as a reimbursable loss because that consent decree related to the activities of more executives at Astra than just Bildman.

¹³² *Astra USA, Inc. v. Bildman*, 455 Mass. 116, 119 (2000) citing *Harrison v. NetCentric Corp.*, 433 Mass. 465, 471, 744 N.E.2d 622 (2001) (stating that Massachusetts applies the law of the company's state of incorporation for matters of internal corporate affairs); See also note 27. Note Astra's tactics of avoiding a claim under the employment contract

¹³³ *Id.* at n27 ("Astra makes no claim of breach of fiduciary duty under the employment agreement, which is governed by Massachusetts law. Its claim for forfeiture is explicitly (and exclusively) based on loyalty principles.")

¹³⁴ *Astra USA, Inc. v. Bildman*, 455 Mass. 116, 130 914 N.E.2d 36, 2009 Mass. LEXIS 655, (2009) quoting *William Floyd Union Free Sch. Dist. v. Wright*, 61 A.D.3d 856, 859 877 N.Y.S.2d 395 (N.Y. 2009) ("The court held that where 'defendants engaged in repeated acts of disloyalty, complete and permanent forfeiture of compensation, deferred or otherwise, is warranted under the faithless servant doctrine.'")

¹³⁵ *Id.* at 136, n.30. See also *Id.* at 134 (stating that under New York law the value of Bildman's services was irrelevant.)

That holding added an award of \$6,779,000 (no prejudgment interest) to the \$1,040,812 of compensating damages. If Massachusetts law had controlled, the trial judge would have had sufficient discretion to deny forfeiture.

In her discretion, the trial judge awarded no punitive damages even though Bildman served no jail time. When she believed that she had discretion to award forfeiture or not, she also rejected forfeiture as damage overkill. The forfeiture amount represents 650% of the compensating damages. It is surprising that Astra secured such a small relative amount of damages for its losses of \$ 2 million wasted on personal uses, \$ 1 million of expense fraud, \$ 250,000 of hush money and investigation costs of \$ 905,080. Astra also failed to secure an award of damages related to the harassment or the EEOC settlement fund. Part of the answer lies in the trial judge's perception that some of Bildman's misbehavior was the result of Astra AB's corporate culture and tolerance.¹³⁶

The trial judge's opinions in Bildman also provides evidence against the notion that the scale and nature of the fiduciary's egregiousness will necessarily affect the outcome of the claim. There was ample evidence of his disloyalty and of the resulting damage and loss to the employer. The case opinions also suggest that he actively tried to hide evidence and may have actually destroyed or erased other evidence.

D.Ian Gittlitz: Remedy Overkill

In a three day trial, the defendant's employer, ICD Publications Inc. ("ICD"), was awarded all damages that it sought: all compensating damages, full compensation forfeiture and two million of punitive damages. Equally significant, the defendant's co-shareholders exercised their right to purchase his stock at book value. The resulting combination seems sure to have caused Gittlitz' financial ruin.

Ian Gittlitz founded ICD Publications Inc. in 1989 with two equal shareholders, Cyndi Evans and David Palcek who had worked together since at least 1987.¹³⁷ ICD produced trade publications for the home housewares industry. Gittlitz operated as president of the company out of the

¹³⁶ Astra USA, Inc. v. Bildman, 2006 Mass. Super. LEXIS 114, *20-21 (Mass. Super. Ct. 2006). ("Here, Bildman's breach of fiduciary duty constitutes serious misconduct. In weighing the equities, however, this court considers that some of Bildman's unsavory behavior may have been in keeping with Astra's corporate culture at the time in question, and tolerated, at least for a time, by the directors.")

¹³⁷ ICD Publs., Inc. v. Gittlitz, 2014 IL App (1st) 133277, 24 N.E.3d 898, 905 (2014)

Long Island office while Evans and Palcek worked in the Lincolnshire, Illinois office. Apparently the company was highly profitable because Gittlitz' compensation between 2000 and 2007 was a total of \$ 6,021,657 which probably reflects his one third share of the three owners' total compensation.¹³⁸ Gittlitz' wife was also employed in the Long Island office as the administrative manager.

Despite annual compensation of almost one million a year, Gittlitz actively defrauded his company in a pattern of expense fraud and unauthorized advances. He and his wife had sole access to ICD's check book, its bank accounts and its credit card records so he was free to double charge invoices for expenses and use the receipts and invoices of other employees to support false expense reports.¹³⁹ Gittlitz also took advances for himself from company funds that he never repaid.¹⁴⁰

In early 2007, Evans and Palcek began to suspect the accuracy of Gittlitz' expense reports. After they confirmed that at least some of his reports were false, they confronted Gittlitz in Orlando on May 7, 2007 when he admitted to a temporary lapse in a small amount.¹⁴¹ The three shareholders signed a letter agreement titled "ICD Publications Change of Financial Controls" (the "CFC Agreement")¹⁴² that reformed the accounting and financial controls as well as retired his wife as administrative manager.¹⁴³

The outside auditor who was subsequently retained quickly discovered that Gittlitz had forged a board resolution and other documents to enhance his financial control over the company accounts.¹⁴⁴ The auditor also determined that Gittlitz had advanced himself \$ 80,000 in March of 2007 and more than one million since 2000.¹⁴⁵

¹³⁸ Id. at 909

¹³⁹ Id. at 904

¹⁴⁰ Ibid.

¹⁴¹ Id. at 905-906 ("Evans testified: "I'm convinced us at that moment that this was a short period of time, was a limited amount of money." Although Gittlitz admitted to submitting invalid expense reports at that meeting, he did not disclose to Evans or Palcek that he had also been embezzling from ICD by writing him-self "advance" checks for many years.")

¹⁴² Id. at 905 ("Furthermore, under the heading "Confidentiality," the document stated that: "Cyndi [Evans] and Dave [Palcek] agree not to seek legal remedies, either criminally or civilly, nor involve the IRS in any findings as it specifically relates to the misuse of company funds provided restitution is made.")

¹⁴³ Ibid.

¹⁴⁴ Id. at 906.

¹⁴⁵ Id. at 906

Evans and Palcek fired Gittlitz on June 21, 2007 and on July 10, 2007 they purchased his stock. The shareholder agreement provided that the shares were to be purchased at their 'book value.' If, as seems likely, ICD is typical of other companies with large amounts of cash flow and small capital requirements, ICD's book value would understate the fair market value of the shares.

In 2009, Gittlitz was arrested and indicted for theft against ICD and pleaded guilty to one count of a Class 3 felony mail fraud relating to his mailing fraudulent expense reports. He specifically acknowledged his fraud between October, 2001 through June, 2007 (69 months)¹⁴⁶ and he made restitution of \$ 250,000.

The civil case followed a familiar pattern. ICD's motion for summary judgment on Gittlitz' liability was granted in July of 2012. The damages trial began on July 26, 2013 during which ICD's expert testified that he found fraudulent transactions for the years from 2000 through 2007 in the cumulative amount of \$ 1,220,623.¹⁴⁷ Gittlitz did not contest the opposing expert's numbers but asserted that Evans and Palcek had 'released him' from liability in the CFC Agreement.¹⁴⁸ The court ruled that even if there had been a waiver it was voidable because it was based on the misrepresentation that Gittlitz's transgressions were relatively small in amount and scope.¹⁴⁹

Compensation forfeiture in Illinois courts is expected to result in full forfeiture against the fiduciary who is found liable for substantial disloyalty but case opinions also emphasizes discretion for the Illinois trial judge.¹⁵⁰ In this case, the court awarded full forfeiture over the period of disloyalty which was confirmed on appeal.¹⁵¹ The package of remedies included compensating damages of \$ 1,220,623 (plus interest of \$ 549,560¹⁵²), forfeiture of \$

¹⁴⁶ Id. at 908

¹⁴⁷ Id. at 909

¹⁴⁸ Despite Gittlitz' decision to not contest the opposing expert, the trial judge described his overall attitude as evasive. See *ICD Pubs., Inc. v. Gittlitz*, 2014 IL App (1st) 133277, P89 (2014) ("Gittlitz similarly argues, without basis in the record, that the trial court's assessment of his lack of credibility was affected by the fact that he suffered a stroke in 2009 that "permanently affected his speech patterns, making it difficult for him to retrieve words, recall events, and express himself as he normally would." Although the trial court noted it found Gittlitz's testimony "evasive" and that Gittlitz had "a difficult time admitting to things which should have been routine," there is no indication that any speech or medical condition precluded him from testifying coherently or affected the court's assessment of his lack of credibility. To the contrary, the trial transcript confirms that Gittlitz repeatedly offered evasive responses before admitting to the extent of his misconduct.")

¹⁴⁹ Id. at 911-12

¹⁵⁰ *In re Marriage of Pagano*, 154 Ill. 2d 174, 190, 607 N.E.2d 1242, 180 Ill. Dec. 729 (1992)

¹⁵¹ *ICD Pubs., Inc. v. Gittlitz*, 2014 IL App (1st) 133277, 24 N.E.3d 898, 914-15 (2014) ("The court's findings were certainly not against the weight of the evidence; to the contrary, the severity of Gittlitz's breach was well established and indeed undisputed.")

¹⁵² Id. at 911-12

6,021,657¹⁵³ (without prejudgment interest) and punitive damages of \$ 2,000,000. It seems doubtful that the book value of his stock would be sufficient to offset this judgement for a total of \$ 9,791,840.

The Gittlitz case raises two technical issues that were not covered in the appellate opinion. In small or closely held companies, the boundary between salary and distributions of profit to ownership is frequently clouded by tax issues. Sometimes profits are disguised as compensation to avoid double taxation on dividends and in other cases, compensation is disguised as profits to avoid social security and medicare taxes.¹⁵⁴ It would have been reasonable to assert that a substantial share of his salary was really his one third share of the profits and that distributions of profit as returns on capital are not subject to forfeiture under any of the supporting rationale.

The second issue relates to the fact that one third of the money that Gittlitz stole belonged to him as a shareholder yet the measure of the damages to ICD never adjusted for this factor. His share of the damages award did not accrue to his benefit because he was forced to sell his stock after his termination and before the trial. His fellow shareholders could argue that when they bought his stock, they also acquired his interest in the company's chose in action except that the formula for the purchase price made no allowance for such an adjustment. Sitting as a court in equity, the trial judge was entitled to stress substance over form and could dismiss that argument or weigh the issue when considering punitive damages or apportionment in forfeiture.

Of the four cases, the result in this case is the most troubling in total amount and seems to exceed the level of punishment normally allowed even for exemplary damages. For stealing \$ 1.2 million, the defendant was ordered to pay a penalty of more than \$ 8 million (an additional 667%) and he was forced to sell his stock at a large discount by his fellow shareholders.

Of the four defendants, Gittlitz's refusal to attempt to reconcile with his partners in May of 2007 also seems the most incomprehensible. His fraud, especially the unauthorized draws, were certain to be discovered and his wife was similarly vulnerable to criminal liability. He would have avoided \$ 8 million of additional liability and might have reconciled or achieved a better salvage value for his stock.

¹⁵³ Id. at 911

¹⁵⁴ James O'Brien, Robert Gray and Greg Stillman, Performing Credible Lost Profits Calculations- Assumptions, Documentation, and Analyses, Chapter 9, The Comprehensive Guide to Lost Profits and Other Commercial Damages (2014) page 230 citing Springs Window Fashions Div., Inc. v. Blind Maker, Inc., 184 S.W.3d 840, 875 (Tex. App.—Austin 2006, pet. granted, judgm't vacated w.r.m.). See also Bettius & Sanderson, P.C. v. National Union Fire Ins. Co., 839 F.2d 1009, 1014 (4th Cir. 1988).

In a famous guest editorial, Alan Dershowitz accused Martha Stewart's lawyers of incompetence because the crimes for which she served time were committed in their presence.¹⁵⁵ Perhaps, Professor Dershowitz overlooked the possibility that she was too irrational at the time to follow the good advice provided by her lawyers, a theory seemingly suggested by these four defendants, especially Gittlitz. Each outlaw failed to attempt an honest reconciliation when offered the chance; they continued to stonewall their way past admissions of felonies and tried to bluster their way past the jury or judge to their inevitable ruin.

E.Kozlowski: Number Four on Time's Top Ten Crooked CEO's

In terms of egregiousness, these four outlaws are not in the same league as Dennis Kozlowski of Tyco International Ltd. ("Tyco") or Richard Scrushy of HealthSouth Corp. (Scrushy will be discussed in section V). Kozlowski is currently ranked number four on Time's list of the Top Ten Crooked CEO's for his crimes and torts while CEO of Tyco. (He stands behind Bernie Madoff (first) and Ken Lay and Jeffrey Skilling (tied for second and third.) Kozlowski would be the head outlaw in this article but for a contradictory case opinion in 2012 from Judge Griesa, a federal district judge in the Southern District of New York that presides over the Tyco cases.

Dennis Kozlowski joined Tyco in 1975 as Director of Internal Audit. He rose in the executive ranks of the company until 1993 when he assumed the titles of CEO and Chairman of the Board. In June 2002, he was fired for cause due to his imminent indictment in New York for sales tax evasion. That indictment led to broader criminal investigation and a trial in 2005 in which he was convicted on 22 of the 23 counts and sentenced to prison.¹⁵⁶

In the criminal trial, Kozlowski was convicted on 12 counts of grand larceny in the first degree (the value of the property taken for each count exceeded \$ 1 million and altogether he was held jointly liable for the theft of more than \$ 100 million); one count of conspiracy to commit larceny; eight counts of falsifying business records; and one count under the state statute for securities fraud. One count of the business records conviction related to his efforts to steal

¹⁵⁵ Alan M. Dershowitz, "With Lawyers Like These...", Wall St. Journal, March 8, 2004 ("One of the most intriguing aspects of the entire Stewart case was never addressed by either side: namely, that virtually every action for which Ms. Stewart was convicted took place after she had consulted with highly experienced and expensive lawyers. As legal ethics expert Stephen Gillers wrote before the trial in The American Lawyer, "defendants ordinarily retain lawyers after they commit their alleged crimes.")

¹⁵⁶ Tyco Int'l, Ltd. v. Kozlowski, 756 F. Supp. 2d 553, 555-56 (S.D.N.Y. December 1, 2010)

money from Tyco under the company's New York City Headquarters Relocation Loan Program and the remaining seven counts relate to his active concealment of his unauthorized borrowings from Tyco.¹⁵⁷

In his 2010 opinion, Judge Griesa granted Tyco's motion for 'partial' summary judgment on the issue of liability for breach of fiduciary duty, inducing breach of fiduciary duty, conspiring to breach fiduciary duty, breach of contract (loan agreements between Tyco and Kozlowski) and conversion. The judge denied Tyco's summary judgment motion on liability for fraud and constructive fraud as well as equitable claims for accounting, constructive trust and unjust enrichment.¹⁵⁸

He went further and granted Tyco's motion for some remedies. He granted Tyco's motion for a declaratory judgment to the effect that the retention agreement between Kozlowski was invalid. Based on his holding that Kozlowski's disloyalty began no later than September of 1995 and continued until his dismissal in June 2002, two other compensation and benefit agreements that were executed after September 1995 were also held invalid owing to the CEO's failure to disclose his breaches of fiduciary duty.¹⁵⁹

The judge addressed compensation forfeiture as the 'faithless servant doctrine' on a number of points. He established substantial evidence about Kozlowski's disloyalty:

After Kozlowski was indicted for sales tax evasion, "An ensuing investigation revealed that Kozlowski had conspired with other corporate officers to pilfer Tyco's treasury of tens of millions of dollars."¹⁶⁰

Kozlowski's convictions for twelve counts of grand larceny and for eight counts of falsification of business records constituted jury findings that he misappropriated property of Tyco with the intent of doing wrong and to deceive.¹⁶¹

¹⁵⁷ Id. at 556-558

¹⁵⁸ Id. at 561-62 ("Tyco brings equitable claims of accounting (sixth cause of action), constructive trust (seventh cause of action), and unjust enrichment (tenth cause of action). Because questions remain as to whether Tyco's claims for damages will be an adequate legal remedy, Tyco's application for summary judgment as to these equitable causes of action is denied.")

¹⁵⁹ Id. at 563

¹⁶⁰ Id. at 556

¹⁶¹ Id. at 561

On the basis of this and other evidence, the judge initially concluded that Kozlowski must forfeit all compensation and benefits.¹⁶² Continuing, the judge stated that Kowlowski must forfeit benefits that accrued under his 'top hat' benefit plans during the disloyalty period.¹⁶³ Finally, he also stated that Kozlowski must forfeit all compensation earned during the period of disloyalty from no later than September 1995 until he was dismissed from Tyco in June 2002.¹⁶⁴

In 2012, Judge Griesa issued a contradictory opinion relating to another motion from Tyco for partial summary judgment for disgorgement of compensation.¹⁶⁵ The judge explains the turnaround as being possible due to an incomplete summary judgment motion: "However, the application of the faithless servant doctrine was not really closed out in the December 1, 2010 opinion, because there were no findings as to actual amounts of compensation or actual sums of money."¹⁶⁶ This is contradicted by his statement that Kozlowski must forfeit all compensation earned September 1995 to June 2002. It would also appear, for example, that the 'top hat' benefit plans are therefore now not necessarily forfeit.¹⁶⁷

Basically, the judge changed his mind about granting summary judgment on compensation forfeiture although not on the breach of fiduciary duty. He raises two factors that were not addressed in the earlier opinion. First, Kozlowski asserts that the faithless servant doctrine only applies when the disloyalty "permeated the employee's service in its most material and substantial part."¹⁶⁸ Second, Kozlowski raises the issue of waiver with a citation to the Aramony cases. The case then holds that Tyco's claim for compensation forfeiture must be resolved as questions of triable fact.¹⁶⁹

¹⁶² Id. at 564 ("In the present case, Kozlowski's multiple breaches of fiduciary duty over several years clearly demonstrate his faithless service. Kozlowski must therefore forfeit all compensation and benefits, deferred or otherwise, earned during his period of disloyalty, which began at its latest in September 1995. Because all of the benefits at issue in these contracts were earned during Kowlowski's period of disloyalty, Tyco is relieved from any obligation to honor them.")

¹⁶³ Id. at 565

¹⁶⁴ Id. at 562

¹⁶⁵ Tyco Int'l, Ltd. v. Kozlowski, 2012 U.S. Dist. LEXIS 32106, *5 (S.D.N.Y. March 9, 2012) ("The court is constrained to say that it has a different view based on the submissions in connection with the current motion. These submissions indicate that neither the parties nor the court made a thorough review of the issues relevant to the faithless servant doctrine in connection with the earlier motion, and that the general statements about the doctrine in the December 1, 2010 opinion do not deal with certain specific issues which the court is obligated to deal with.")

¹⁶⁶ Id. at *4

¹⁶⁷ See note 165 *infra*.

¹⁶⁸ Id. at *5 quoting Sanders v. Madison Square Garden, L.P., No. 06 Civ. 589 (GEL), 2007 U.S. Dist. LEXIS 48126, at *14 (S.D.N.Y. July 2, 2007)

¹⁶⁹ Id. at *6

Therefore, Dennis Kozlowski's contribution to the law of compensation forfeiture is yet to be determined. At present, in light of the evidence that Judge Griesa himself recounted, it seems hard to imagine how Kozlowski can prove that his disloyalty did not permeate his service. Even without considering all of the additional colorful egregiousness already reported in the media,¹⁷⁰ any finding of less than full forfeiture against a CEO with 20 related convictions would act as a small earthquake to shake the foundations of the faithless servant doctrine and forfeiture compensation in New York.¹⁷¹

III Breach of Fiduciary Duty

The cases discussed in the previous section are not necessarily typical but they demonstrate the variety of remedies that can be combined for a fiduciary claim and some of the issues that appear regularly in these cases. There are few other areas of the law in which there are so many options with so few restrictions. They also demonstrate how the cause of action for breach of fiduciary duty can lead to multiple remedies. Enstar secured six remedies against Grassgreen, UWA and ICN secured three against Aramony and Gittlitz and Astra secured two remedies against Bildman.

A. Dual Goals and Multiple Remedies

¹⁷⁰ Time, Top 10 Crooked CEO's ("There's no denying Kozlowski led a lavish lifestyle. His \$30 million New York City apartment was allegedly paid for by the company. (The shower curtains alone, it was revealed in court, cost \$6,000.) Tyco also footed half of the \$2 million bill for an extravagant birthday party for Kozlowski's second wife in 2001. Disguised as a shareholder meeting, it took place on an Italian island and featured an ice sculpture of the Statue of David urinating Stolichnaya vodka. The bash—which became known as the Tyco Roman Orgy—probably didn't help his case.")

¹⁷¹ One new piece of evidence recounted in the second opinion relates to the fact that Kozlowski had made restitution to Tyco for \$ 97 million. Judge Griesa made no mention of whether this restitution represented full restitution or was paid pursuant to some settlement agreement with Tyco nor did the judge indicate how, if at all, this new fact might adjust any legal issues. See Tyco Int'l, Ltd., 2012 U.S. Dist. LEXIS 32106 at *3.

The dual goals¹⁷² for breach of fiduciary duty are (1) to compensate the principal for loss or damages¹⁷³ and (2) to deter further disloyalty by disgorging any profit related to the breach.¹⁷⁴ To satisfy both goals, a remedy in equity and a remedy at law will generally be required. As a result, combinations of two remedies for one claim of breach of fiduciary duty is commonplace¹⁷⁵ and combinations of three or more is not unusual in packages that include forfeiture.¹⁷⁶

The combination of a remedy in equity and a remedy at law tends to resemble a "stack" or pile rather than two remedies that fit or mesh together because the merger of courts at law and courts in equity failed to merge the substance of the two bodies of law. By 1873, the majority of

¹⁷² *Rash v. J.V. Intermediate, Ltd.*, 498 F.3d 1201, 1212 (10th Cir. Tex. 2007)("Forfeiture is based on two propositions: (1) the principal is considered not to have received what he bargained for if the agent breaches his fiduciary duties while representing the principal, *id.* at 237-38, and (2) fee forfeiture is designed to discourage agents from being disloyal to their principal or "to protect relationships of trust by discouraging agents' disloyalty.") and *Hendry v. Pelland*, 73 F.3d 397, 402 (1996) ("Compensatory damages make plaintiffs whole for the harms that they have suffered as a result of defendants' actions. Clients therefore need to prove that their attorney's breach caused them injury so that the trier of fact can determine whether they are entitled to any damages. Forfeiture of legal fees serves several different purposes. It deters attorney misconduct, a goal worth furthering regardless of whether a particular client has been harmed. It also fulfills a longstanding and fundamental principle of equity--that fiduciaries should not profit from their disloyalty.").

¹⁷³ Douglas Laycock, *Modern American Remedies: Cases and Materials* 15 (2d ed. 1994) ("The fundamental principal of damages is to restore the injured party as nearly as possible to the position he would have been in but for the wrong - is the essence of compensatory damages.")

¹⁷⁴ Restatements of the Law 3d, *Restitution and Unjust Enrichment* 2011, § 43 b. The function of restitution. The basic determination that opens the way to restitution within the rule of this section is always the same: that there has been trust and confidence justifiably reposed on one side, and an advantage improperly gained on the other, either in violation of fiduciary duty or in circumstances posing so great a risk of violation that violation is presumed as a matter of law. Any such advantage must be given up to the beneficiary.

¹⁷⁵ *Shaeffer v. Blair*, 149 U.S. 248, 258 (1893) citing *Denver v. Roane*, 99 U.S. 355 (holding that the plaintiff was to receive compensating damages in the form of reimbursement of his expenditures and the defendant was to be denied previously agreed commissions.); *Phansalkar v. Andersen Weinroth & Co., L.P.*, 344 F.3d 184, 203-204 (2d Cir. N.Y. 2003)(awarding officer's secret profit and forfeiture); *Efird v. Clinic of Plastic & Reconstructive Surgery, P.A.*, 147 S.W.3d 208, 221 (Tenn. Ct. App. 2003)(holding that the defendant was terminated for cause and thereby reversed the employer's liability for compensation under the employment agreement and remanding the case to determine if the defendant was either an officer or director of the employer which, if so, would determine his liability for disloyalty and damages from disloyal competition.); *DeCoursey v. Stickney*, 2010 Wash. App. LEXIS 2507, *27 (Wash. Ct. App. Nov. 8, 2010)(actual damages and forfeiture for fiduciary's conflict); *Moore & Co. v. T-A-L-L, Inc.*, 792 P.2d 794, 800 (Colo. 1990)(stating in a case failure to disclose "If, of course, a real estate broker's breach of fiduciary duty causes actual loss to the seller, the broker not only forfeits the commission but also is liable for the full amount of the loss."); and *Henderson v. Rep Tech, Inc.*, 162 A.D.2d 1028, 557 N.Y.S.2d 224, 225(N.Y. App. Div. 4th Dep't 1990 (awarding injunctive relief and forfeiture for breach of the principal's confidentiality). See also Story on Agency, section 331 ("If the agent does not perform his appropriate duties, or if he is guilty of gross negligence or gross misconduct or gross unskillfulness in the business of his agency, he will not only become liable to his principal for any damages which he may sustain thereby, but he will also forfeit all his commissions.")

¹⁷⁶ For examples, see Appendix 1.

American states had adopted a version of the Field Code which merged the two courts.¹⁷⁷ The resulting merger consolidated court rooms and court personnel but there has been little progress in merging the two bodies of substantive law.¹⁷⁸ The problem remains about how to weave in the remedies law from both sources rather than merely adding one on top of the other.

For example, the goal of compensating damages is to restore the claimant to her *ex ante* position while the goal of disgorgement is to restore the defendant to her *ex ante* position by transferring unjust enrichment from the defendant to the principal.¹⁷⁹ Second, neither remedy is dynamic or takes into account the effect of the other: when compensating damages and forfeiture are combined, the claimant's loss is not adjusted for the effect of disgorging the defendant's unjust enrichment nor is the disgorgement measured by adjusting the defendant's unjust enrichment for the obligation to pay damages to the claimant.

Another area in which the two bodies of law do not presently fit together very well relates to remedies that seek to deter disloyalty or other breaches of fiduciary duty. The law in equity did not originally award punitive damages,¹⁸⁰ but it promoted deterrence by disgorging any unjust profits from the defendant even when windfalls to the plaintiff were likely.¹⁸¹ The Supreme

¹⁷⁷ See Thomas O. Main, *Traditional Equity and Contemporary Procedure*, 78 Wash. L. Rev. 429, 431, 464-65 (2003)

¹⁷⁸ *Rogers v. Daniel Oil & Royalty Co.*, 110 S.W.2d 891, 894 (Tex. 1937) ("In spite of this blended system of law and equity the distinction between them is as absolute as ever, and to entitle the plaintiff to equitable relief he must show a proper case for a court of equity to exercise its equitable jurisdiction."); see also *Ochoa v. Am. Oil Co.*, 338 F. Supp. 914, 920 (S.D. Tex. 1972) ("Although the equity side and the law side of the federal trial courts were thus fused, we are still far from the time ... when lawyers will cease to inquire whether a given rule be a rule of equity or a rule of common law." (internal quotation omitted)); Thomas O. Main, *Traditional Equity and Contemporary Procedure*, 78 Wash. L. Rev. 429, 476 (2003) ("As with the Field Code and the Federal Rules of Civil Procedure, the Judicature Acts of 1873 and 1875, fused only the procedure of law and equity, leaving the substance of equity both intact and predominant ... "); and Dominic O'Sullivan et al., *The Law of Rescission* §§10.04 (2008) (stating that British fusion did not substantially combine the substance of either body of law).

¹⁷⁹ Colleen Murphy, *Misclassifying Monetary Restitution*, 2002 55 SMU L. Rev. 1577, 1625 n.265 ("Restitution aims at the defendant's [rightful position]. Disgorgement is the key concept. By making the defendant disgorge the benefits he cannot justly retain, the law of restitution returns the defendant to the position he should, 'in equity and good conscience,' have occupied." (quoting David Schoenbrod et al., *Remedies: Public and Private* 727 (3d Ed. 2002))).

¹⁸⁰ *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 270 (1993) ("As this Court has long recognized, courts of equity would not - absent some express statutory authorization - enforce penalties or award punitive damages.")

¹⁸¹ *Randall v. Loftsgaarden*, 478 U.S. 647, 663-64 (1986) (acknowledging that the remedy in equity as applied in *Affiliated Ute Citizens of Utah* "clearly does more than simply make the plaintiff whole for the economic loss proximately caused by the buyer's fraud," but that such a windfall was a significant part of the securities law's deterrent purpose (quoting *Janigan v. Taylor*, 344 F.2d 781, 786 (1st Cir. 1965))); *Mishawaka Rubber & Woolen Mfg. Co. v. S.S. Kresge Co.*, 316 U.S. 203, 206-07 (1942) ("The burden is the infringer to prove that his infringement had no cash value in sales made by him. If he does not do so, the profits made on sales of goods bearing the infringing mark properly belong to the owner of the mark. There may well be a windfall to the trade-mark owner where it is impossible to isolate the profits which are attributable to the use of the infringing mark. But to hold

Court has explained in the past that disgorgement is self-limiting or restrained by the fact that disgorgement can award no more than the defendant's actual profits.¹⁸²

In modern times, most courts now permit the award of punitive damages for claims of breach of fiduciary duty and occasionally punitive damage awards stacked on top of disgorgement or forfeiture.¹⁸³ When all three remedies are combined, the court is awarding three remedies to deter future breaches yet there is no acknowledged interaction or need to adjust between them for the award of the other remedies. None of the cases in Section II that considered punitive damages mentioned the simultaneous award of disgorgement or forfeiture as a consideration. The only restraint on excessive deterrence remedies is the equitable discretion of the trial judge. Seemingly, the rationale of deterrence is not a 'blank check' for an excessive combination of remedies, i.e. after a point, it seems unreasonable to expect a greater amount of remedies to meaningfully add to the deterrence.¹⁸⁴ In the Grassgreen case, for example, the trial judge noted that Alabama law intends that exemplary damages punish but not destroy the defendant.¹⁸⁵

otherwise would give the windfall to the wrongdoer." (citation omitted)); and *Lee v. Lee*, 47 S.W.3d 767, 780 (Tex. App. - Houston [14th Dist.] 2001, pet. denied) ("Under the facts of this case, it is more appropriate for the estate to obtain the benefit of a windfall than to let appellee keep \$ 1.5 million in fees the jury found was unreasonable.")

¹⁸² *Snepp v. United States*, 444 U.S. 507, 515-16 (1980) (per curiam) (explaining that constructive trust remedies "[conform] relief to the dimensions of the wrong ... since the remedy reaches only funds attributable to the breach, it cannot saddle the [fiduciary] with exemplary damages out of all proportion to [the] gain").

¹⁸³ See Appendix 1 for a summary of cases that have stacked multiple remedies. See also *In re Marriage of Pagano*, 607 N.E.2d 1242, 1249-1250 (Ill.1992) (noting that forfeiture may be justified as matter of public policy when breach is "egregious" and stating that "punitive damages are permissible where a duty based on a relationship of trust is violated, the fraud is gross, or malice or willfulness are shown. . . .")

¹⁸⁴ See *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 424-25(2003) (stating that the court would not hand down a bright line rule for limiting punitive damages while suggesting that under normal conditions, the ratio should be about four to one or less subject to the following considerations: "Nonetheless, because there are no rigid benchmarks that a punitive damages award may not surpass, ratios greater than those we have previously upheld may comport with due process where "a particularly egregious act has resulted in only a small amount of economic damages." *Ibid.*; see also *ibid.* (positing that a higher ratio might be necessary where "the injury is hard to detect or the monetary value of noneconomic harm might have been difficult to determine"). The converse is also true, however. When compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee. The precise award in any case, of course, must be based upon the facts and circumstances of the defendant's conduct and the harm to the plaintiff.")

¹⁸⁵ See note 66 *infra* and accompanying text. See also *Ace Truck & Equip. Rentals v. Kahn*, 103 Nev. 503, 746 P.2d 132, 1987 Nev. LEXIS 1865 (1987)("The most frequently cited rule is that the amount of punitive damages assessed should be sufficient to punish a wrongdoer and deter others from acting in a similar manner without financially annihilating the defendant."); and *Maxwell v. Aetna Life Ins. Co.*, 143 Ariz. 205, 693 P.2d 348, 362 1984 Ariz. App. LEXIS 521 (Ariz. Ct. App. 1984)(" While the verdict must be sufficient to punish and deter others in similar circumstances, it must not financially kill the defendant.")

In Texas, an award of a remedy in equity can increase the limit on punitive damages. The plaintiff must prove at least some actual damages to warrant punitive damages but it has been held that the dollar value of remedies in equity can be used as a proxy value for actual damages.¹⁸⁶ Thus, at least in Texas, the award of forfeiture or disgorgement of compensation might actually justify the award of more punitive damages than without the forfeiture remedy.

B.Categories of Remedies Available For Breach Of Fiduciary Duty

Compensating damages include out of pocket or incidental losses such as wasted assets;¹⁸⁷ travel and entertainment expense fraud¹⁸⁸ or the cost to replace lost assets such as retraining personnel¹⁸⁹ and lost profits.¹⁹⁰

¹⁸⁶ See *Nabours v. Longview Sav. & Loan Ass'n*, 700 S.W.2d 901, 904 (Tex. 1985) ("As in other cases where equity requires the return of property, this recovery of the consideration paid as a result of fraud constitutes actual damages and will serve as a basis for the recovery of exemplary damages." (internal citation omitted)) and *Russell v. Truitt*, 554 S.W.2d 948, 955 (Tex. Civ. App. - Fort Worth 1977, writ ref'd n.r.e.) ("The forfeiture of the \$ 8,000.00 in agency fees is a form of equitable relief awarded for the breach of the equitable duties of those in a fiduciary role. Accordingly, under the rule in *International Bankers Life*, no actual damages are necessary to support the exemplary damage award." (citation omitted)).

¹⁸⁷ *Astra USA, Inc. v. Bildman*, 2006 Mass. Super. LEXIS 114, *1 (Mass. Super. Ct. 2006)

¹⁸⁸ E.g. see note 147 *infra* and accompanying text.

¹⁸⁹ *Chelsea Industries, Inc. v. Gaffney*, 389 Mass. 1, n23 (Mass. 1983) citing *Frederick Chusid & Co. v. Marshall Leeman & Co.*, 326 F. Supp. 1043, 1060-1061 (S.D. N.Y. 1971).

¹⁹⁰ *Dowd & Dowd, Ltd. v. Gleason*, 352 Ill. App. 3d 365, 816 N.E.2d 754 (Ill. App. Ct. 2004)(awarding \$ 871,2000 in lost profits in addition to \$ 780,000 of other compensating damages); *Vigneau v. Engineers*, 1995 Conn. Super. LEXIS 3361, *22 (Conn. Super. Ct. Dec. 4, 1995) (awarding compensating damages of \$ 58,923 for lost profits in a claim for disloyal competition); and *Swinnea v. ERI Consulting Eng'rs, Inc.*, 364 S.W.3d 421, 424-25 (Tex. App. - Tyler 2012, pet. denied) (reducing lost profits from \$ 300,000 to \$ 178,601.05, affirming the punitives of \$ 1,000,000, and remanding the asset forfeiture to the trial court for consideration of the factors enumerated in the Supreme Court opinion).

Lost profits are mutually exclusive with disgorgement¹⁹¹ as they are pled in the alternative¹⁹² and applied disgorgement as a proxy for the plaintiff's damages in other areas of the law.¹⁹³

¹⁹¹ *Vibra-Tech Eng'rs, Inc. v. Kavalek*, 849 F. Supp. 2d 462, 488 2012 U.S. Dist. LEXIS 43150 (D.N.J. 2012)(awarding the higher of lost profits or disgorgement.) But see note 398 *infra* and accompanying text.

¹⁹² *McGowan & Co. v. Bogan*, 2015 U.S. Dist. LEXIS 68144, *16 (S.D. Tex. May 27, 2015)(" Plaintiff clarifies that it seeks "lost profits" or, in the alternative, "the amount Bogan was unjustly enriched."); *In re Longview Energy Co.*, 2015 Tex. LEXIS 438, *15 (Tex. 2015)(" Disgorgement is compensatory in the same sense attorney fees, interest, and costs are, but it is not damages. Indeed, Longview has itself made clear that it sought disgorgement instead of damages, and did not request jury findings on damages, because it thought the Eagle Ford shale assets were undervalued."); *Saint Alphonsus Diversified Care, Inc. v. MRI Assocs., LLP*, 157 Idaho 106, 127 (Idaho 2014)("The loss of value award to MRI Center of \$25,420,000 was an alternative to its award of lost profits in the sum of \$25,828,208, and the disgorgement award of \$21,353,838 was in alternative to all other awards to the MRI Entities, the largest of which total \$52,084,513."); and *Quality Health Care Mgt. Inc. v. Kobakhidze*, 2013 N.Y. Misc. LEXIS 6674, 2013 NY Slip Op 33735(U) (N.Y. Sup. Ct. Feb. 22, 2013) citing *Gomez v Bicknell*, (302 AD2d 107, 114 [2d Dept 2002])(" Remarking that the purpose of damages for such breach was not only to compensate for wrongs, but to prevent them (citing *Diamond v Oreamuno*, 24 NY2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 [1969])), the court stated that a prevailing plaintiff may elect the remedy for such a breach to be calculated as either the disgorgement of the gain to the disloyal employee, or the employer's lost profits.").

¹⁹³ Disgorgement has been used as proxy for the plaintiff's damages in claims relating to breach of fiduciary duty: *Meister v. Mensinger*, 230 Cal. App. 4th 381, 178 Cal. Rptr. 3d 604, 2014 Cal. App. LEXIS 896 (Cal. App. 6th Dist. 2014)("Typically, the defendant's benefit and the plaintiff's loss are the same, and restitution requires the defendant to restore the plaintiff to his or her original position.") quoting *County of San Bernardino v. Walsh* (2007) 158 Cal.App.4th 533, 542 [69 Cal. Rptr. 3d 848] and *Arabesque Studios, Inc. v. Academy of Fine Arts, Int'l, Inc.*, 529 S.W.2d 564, 569 (Tex. Civ. App. - Dallas 1975, no writ) (holding that the new employer's profits could be used to measure damages for a prior employer's damages in the case of an employee's breach of covenant to not compete) and relating to claims for misappropriation of intellectual property: *Swofford v. B & W, Inc.*, 336 F.2d 406, 411 (5th Cir. 1964) ("The profits which were recoverable in equity against an infringer of a patent were compensation for the injury the patentee had sustained from the invasion of his rights. Such profits were considered the measure of the patentee's damages. It was very early recognized that, "though called profits, they are really damages." (quoting *Mowry v. Whitney*, 81 U.S. (14 Wall.) 620, 653 (1872))); *Sandare Chem. Co., Inc. v. WAKO Int'l, Inc.*, 820 S.W.2d 21, 23 (Tex. App.—Fort Worth 1991, no writ) ("An unjust enrichment measure of damages is appropriate for wil[li]ful interference with contractual relations, at least where the plaintiff's lost profits are not readily ascertainable."); Restatement (Third) of Restitution & Unjust Enrichment §42 cmt. d ("To the extent that the defendant's profits from infringement represent profits the plaintiff would otherwise have earned, the calculation of "infringer's profits' becomes an indirect mode of showing "plaintiff's damages,' and the same amount might be recovered under either heading - subject to protection against double-counting. Such a conception evidently underlies the language of the Copyright Act, 17 U.S.C. § 504(b), which directs recovery of "actual damages' plus "profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages.');

Attorney Gen. v. Blake, [2001] 1 A.C. 268, 279-80 (H.L.) (appeal taken from Eng.) (U.K.) ("Thus, in 1803 Lord Eldon L.C. stated, in *Hogg v. Kirby* a passing off case: "what is the consequence in Law and in Equity? ... a Court of Equity in these cases is not content with an action for damages; for it is nearly impossible to know the extent of the damage; and therefore the remedy here, though not compensating the pecuniary damage except by an account of profits, is the best: the remedy by an injunction and account."); *George E. Palmer, The Law of Restitution* § 2.7 (1978) ("Decisions of the United States Supreme Court in the nineteenth century established that in a suit in equity for infringement of patent or copyright, the patent or copyright holder was entitled to recover the profits made through the infringement. Although the Court sometimes explained this as a method for measuring the plain-tiff's damages, it was clear that the relief was based on unjust enrichment, as the Court later recognized. In the cases during this earlier period, recovery of profits could be obtained only in equity, where there was an independent basis for an injunction.

Lost future profits are also mutually exclusive with future disgorgement¹⁹⁴ or injunctive relief.¹⁹⁵ Thus the claimant for disloyal competition can claim either lost future unjust enrichment or lost future profits or seek to enjoin the defendant's competition but not both.¹⁹⁶ A third alternative to lost profits or disgorgement is the claimant's lost enterprise value.¹⁹⁷

Like future lost profits or future unjust enrichment, consequential damages are also possible but require strong justification.¹⁹⁸ As a remedy at law, it would require the standard proof of causation although the plaintiff should expect additional scrutiny as the damages alleged appears more and more remote.¹⁹⁹

¹⁹⁴ For cases on future unjust enrichment, see generally *Children's Broad. Corp. v. Walt Disney Co.*, 357 F.3d 860, 869 (8th Cir. 2004); *Fin. Programs, Inc. v. Falcon Fin. Servs., Inc.*, 371 F. Supp. 770 (D. Or. 1974) (applying Oregon law); *Am. Speedy Printing Ctrs. v. AM Mktg., Inc.*, 69 F. App'x 692, 699 (6th Cir. 2003) (awarding franchisor "lost future profits"); *JTH Tax Inc. v. H&R Block E. Tax Servs.*, 245 F. Supp. 2d 749, 750-51 (E.D. Va. 2002) (calculating net present value of six years' worth future earnings); *Dozor Agency, Inc. v. Rosenberg*, 218 A.2d 583, 586 (Pa. 1966) (using the present value of projected income to calculate damages); *White-side Biomechanics v. Sofamor Danek Group*, 88 F. Supp. 2d 1009, 1020 (E.D. Mo. 2000) (recognizing jury's verdict at trial level as incorporating future damages); and *Broan Mfg. Co., Inc. v. Associated Distribs., Inc.*, 923 F.2d 1232, 1237 (6th Cir. 1991) (holding that jury's calculation of future damages was not "speculative").

¹⁹⁵ *Next Level Commc'ns L.P. v. DSC Commc'ns Corp.*, 179 F.3d 244, 254 (5th Cir. 1998) ("In its appellate brief, DSC again argued that it was entitled to a limited permanent injunction in addition to monetary damages to prevent the transfer or disclosure of its trade secrets This court rejected DSC's arguments and affirmed the district court's refusal to grant either type of injunction."); *AngioScore, Inc. v. TriReme Med., Inc.*, 2015 U.S. Dist. LEXIS 86041, *115 (N.D. Cal. July 1, 2015) ("Thus, the Court awards AngioScore (i) its current lost profits of \$2.97 million, representing the profits it would have generated had business not been diverted to defendants, and (ii) its future lost profits where, as here, the Court declines to issue an injunction and permits Chocolate to stay on the market."); and *Home Pride Foods, Inc. v. Johnson*, 634 N.W.2d 774, 784 (Neb. 2001) ("The court's award for the value of future sales is inconsistent with the issuance of a permanent injunction. ").

¹⁹⁶ *Next Level Commc'ns L.P. v. DSC Commc'ns Corp.*, 179 F.3d 244, 254 (5th Cir. 1998)

¹⁹⁷ *Prime Mortgage USA, Inc. v. Nichols*, 885 N.E.2d 628, 638 (Ind. Ct. App. 2008) ("On October 16, 2006, the trial court entered its judgment awarding Nichols \$ 2,500,000 in compensatory damages for the value of her 50% ownership in Prime, trebled to \$ 7,500,000; \$ 6,330.02 in unpaid wages, trebled to \$ 18,990.06; and \$ 402,891.28 in attorney's fees.") and *Vendo Co. v. Stover*, 58 Ill.2d 289,314, 321 N.E.2d 1, 10 (1974)(awarding total damages of \$ 7,345,000 that includes \$ 2,135,000 of lost profits; \$ 170,835 of compensation forfeiture; and \$ 5,039,165 of lost value of the employer's enterprise.)

¹⁹⁸ *Milbank, Tweed, Hadley & McCloy v. Boon*, 13 F.3d 537, 543 (2d Cir.1994) (awarding consequential damages without proof that injury was expected for foreseeable); Restatements of the Law 3d, Restitution and Unjust Enrichment 2011, § 43 h. Consequential gains. ("Disgorgement liability by the rule of § 43 is not restricted to conscious wrongdoers. In contrast to the property-based rules of §§ 40-42, the prophylactic aims of fiduciary duty require a fiduciary to disgorge profits (including consequential gains) even if the breach of duty is inadvertent. The same liability is imposed on a third party who acquires a benefit with notice of the fiduciary's breach of duty. By contrast, an innocent third party who obtains property as a result of another's breach of trust is liable to make restitution of what has been received but not for consequential gains. See Illustration 35 and § 50(5).")

¹⁹⁹ For Texas see note 211 *infra* (proximate cause) and for New York see note 97 *infra* (substantial factor or proximate cause.)

Compensation forfeiture requires no proof of other damage²⁰⁰ and is not mutually exclusive with other remedies.²⁰¹ Alternatively, the claimant can accomplish implicit forfeiture by ensuring the exclusion of any credit or offset for the fiduciary's compensation in an accounting in equity or in the measure of the defendant's unjust enrichment.²⁰²

Punitive damages are also available in most states with the noted exception of Delaware.²⁰³ However, in the determination of whether a claim is in equity or at law, the plea for punitive damages is generally still regarded as a remedy at law.

Remedies in equity are also available in addition to the categories above or instead of compensating or consequential damages. As both the Restatement of Agency and Professor Laycock point out, a remedy in equity is especially important when it is the only remedy available.²⁰⁴ A number of case opinions have approved a remedy in equity because damages were difficult or too speculative in amount to award.²⁰⁵

²⁰⁰ See note 212 *infra*

²⁰¹ Restatement of the Law, Third, Agency (2006), § 8.01 General Fiduciary Principle d. Remedies for breach of fiduciary duty 2. ("Forfeiture may be the only available remedy when it is difficult to prove that harm to a principal resulted from the agent's breach or when the agent realizes no profit through the breach. In many cases, forfeiture enables a remedy to be determined at a much lower cost to litigants.")

²⁰² See *Hahn v. OnBoard, LLC*, 2011 U.S. Dist. LEXIS 16633 (D.N.J. Feb. 18, 2011) ("When an employee violates the duty of loyalty, the employer "has a choice of remedies" to recover any benefits conferred upon the employee during the period of disloyalty, including wages paid to the employee.") and *Henderson v. Rep Tech, Inc.*, 162 A.D.2d 1028, 557 N.Y.S.2d 224, 225(N.Y. App. Div. 4th Dep't 1990) ("The compensation paid an employee during the period of disloyalty is a component of the profit for which an employee must account and is subject to forfeiture.") See also Restatements of the Law 3d, Restitution and Unjust Enrichment 2011, § 43 h. Consequential gains and Illustrations 10, 11 and 12.

²⁰³ See Restatement of the Law, Third, Agency (2006) § 8.01 General Fiduciary Principle d. Remedies for breach of fiduciary duty ("A breach of fiduciary duty may also subject the agent to liability for punitive damages when the circumstances satisfy generally applicable standards for their imposition. For general standards applicable to awards of punitive damages, see Restatement Second, Torts § 908(2). In these respects, the consequences of a breach of fiduciary duty do not differ from those of other torts that an agent may commit against a principal.") For examples of punitive damages see Appendix 1. For Delaware cases that deny punitive damages as a matter of law see *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2004 Del. Super. LEXIS 303, p*21 (Del. Super. Sept. 15, 2004) ("While it is true that a fraud allegation can support punitive damages, many types of fraud, including all those involving breach of fiduciary duty, are heard exclusively in Chancery without possibility of punitive damages.")

²⁰⁴ See Douglas Laycock, *The Scope and Significance of Restitution*, 67 Tex. L. Rev. 1277, 1284 (1989) ("The restitutionary claim matters in three sets of cases: (1) when unjust enrichment is the only source of liability; (2) when plaintiff prefers to measure recovery by defendant's gain, either because it exceeds plaintiff's loss or because it is easier to measure; and (3) when plaintiff prefers specific restitution, either because defendant is insolvent, because the thing plaintiff lost has changed in value, or because plaintiff values the thing he lost for nonmarket reasons.") and see note 196 *infra*.

²⁰⁵ *Woods v. City Nat'l Bank & Trust Co.*, 312 U.S. 262, 268 (1941) ("Furthermore, the incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past

If the disloyal fiduciary has transferred legal title to an asset that needs changing or executed a contract that needs to be amended or voided, injunctive relief or in personam authority will be required.²⁰⁶ An accounting in equity or a constructive trust may be needed to allow the court to supervise further discovery²⁰⁷ or to grant the principal a security position against the defendant.²⁰⁸

When the principal sues a third party such as a competitor, she can claim either damages or unjust enrichment against a third party and still sue the fiduciary for any profit or benefit that

transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent. Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation.”); *Nichols v. Minnick*, 885 N.E.2d 1, 5, 2008 Ind. LEXIS 329 (Ind. 2008) citing Restatement (Third) of Agency § 8.01 cmt. d(2) (2006) (“Harm to the plaintiff is not required for several reasons. First, disgorgement may be “the only available remedy” for an agent's breach of fiduciary duty because harm to the principal is difficult to prove.”) and *Maritrans GP, Inc. v. Pepper, Hamilton & Scheetz*, 529 Pa. 241, 260-61, 602 A.2d 1277, 1992 Pa. LEXIS 36 (1992) (On these facts, it was perfectly reasonable to conclude that Maritrans' competitive position could be irreparably injured if Pepper and Messina continued to represent their competitors and that Maritrans' remedy at law, that is their right to later seek damages, would be difficult if not impossible to sustain because of difficult problems of proof, particularly problems related to piercing what would later become a confidential relationship between their competitors and those competitors' attorneys (Pepper and Messina).); and *United Board & Carton Corp. v. Britting*, 63 N.J. Super. 517, 532 (Ch.Div. 1959) (“It is a well established rule that equity will intervene to grant equitable relief when the damages at law are inadequate, or not readily calculable.”)²⁰⁶ 1 *Dobbs*, *Law of Remedies*, supra note 11, §4.4, at 610 (“Specific restitution is not the result of an incantation. It does not matter whether the words constructive trust or reformation are used. If the plaintiff traces his real property into the hands of the defendant and the plaintiff is entitled to restitution, then specific restitution is appropriate. If a court wants to speak of rescission rather than constructive trust, an order requiring restitution is still appropriate.”)

²⁰⁷ *Maritime Fish Products, Inc. v. World-Wide Fish Products, Inc.*, 100 A.D.2d 81, 91 (N.Y. App. Div. 1st Dep't 1984)(“ Thus, an accounting is warranted to ascertain the damages resulting from Christensen's diversion of business during the entire 14-month period from December, 1975, when he incorporated World-Wide, until February 11, 1977, when he resigned from Maritime.”) and *Durwood v. Dubinsky*, 361 S.W.2d 779, 790 1962 Mo. LEXIS 596 (Mo. 1962) (“In the event of improper conduct on the part of an employee, as above referred to, the employer usually has an action at law for damages, but frequently the actual damages would be speculative and not subject to proof. In such situation a court of equity will, in the proper circumstances, afford relief to the employer by the imposition of a constructive trust in his favor on the profits and property wrongfully acquired by the employee.”)

²⁰⁸ *Radenhausen v. Doss* 819 So. 2d 616,620 (Ala. 2001)(“A constructive trust may be impressed upon property when the grantee of the property has abused a confidential relationship with the grantor.” (quoting *Jordan v. Mitchell*, 705 So. 2d 453, 461 (Ala. Civ. App. 1997))) and *Lerner Corp. v. Three Winthrop Props., Inc.*, 124 Md. App. 679, 691(1999) citing Section 399(d) of the Restatement (Second) of Agency Restatement of Restitution, section 200, entitled “Using Confidential Information,”(“Where a fiduciary in violation of his duty to the beneficiary acquires property through the use of confidential information, he holds the property so acquired upon a constructive trust for the beneficiary.”); and *Schock v. Nash*, 732 A.2d 217, 231 (Del. 1999)(granting a constructive trust against the fiduciary in breach and members of her family to secure assets wrongfully removed from a trust account.)

he retained as well as his compensation.²⁰⁹ In some circumstances, the principal can also collect legal costs from the fiduciary for the expense of having to sue the third party.²¹⁰

C.Causation and Burden of Proof

There is a substantial difference in the evidence required for a prima facie case for breach of fiduciary duty between a claim based on a remedy in equity or a remedy at law.²¹¹ Thus a claim for compensation forfeiture has a lesser burden of proof owing to the fact that compensation forfeiture is treated as a remedy in equity. Proof of loss or damage to the claimant is not required.²¹² Note also the passive language in the Restatement of the Law Third, Restitution and Unjust Enrichment ("Restatement of Restitution") that is used to avoid a requirement for

²⁰⁹ *W. Reserve Life Assurance Co. of Ohio v. Graben*, 233 S.W.3d 360, 368 (Tex. App. - Fort Worth 2007, no pet.) (approving award of lost profits as actual damages and disgorgement of 100% of the commissions from a third party); *Tarnowski v. Resop*, 236 Minn. 33, 37 (1952) ("If an agent has violated a duty of loyalty to the principal so that the principal is entitled to profits which the agent has thereby made, the fact that the principal has brought an action against a third person and has been made whole by such action does not prevent the principal from recovering from the agent the profits which the agent has made."); Restatement of the Law, Third, Agency (2006), § 8.01 General Fiduciary Principle, cmt. b. ("A third party who, knowing that the agent's conduct constitutes a breach of duty, provides substantial assistance to the agent is also subject to liability to the principal.")

²¹⁰ *Tarnowski v. Resop*, 236 Minn. 33, 39-40 LEXIS 622 (1952) ("Plaintiff sought to return what had been received and demanded a return of his down payment. The sellers refused. He thereupon sued to accomplish this purpose, as he had a right to do, and was successful. His attorneys' fees and expenses of suit were directly traceable to the harm caused by defendant's wrongful act. As such, they are recoverable.")

²¹¹ *Yaquinto v. Segerstrom (In re Segerstrom)*, 247 F.3d 218, 226 (5th Cir. 2001) ("While the Texas Supreme Court has dispensed with the need to prove an actual injury and causation when a plaintiff seeks to forfeit some portion of an attorney's fees in connection with a breach of fiduciary duty, see *Burrow v. Arce*, 997 S.W.2d 229, 240 (Tex. 1999), injury and causation are still required when a plaintiff seeks to recover damages for a breach of fiduciary duty."); *Hendry v. Pelland*, 73 F.3d 397, 401 (1996) ("Although we have found no District of Columbia cases precisely on point, courts in other jurisdictions have held that clients must prove injury and proximate causation in a fiduciary duty claim against their lawyer if they seek compensatory damages, not if, as here, they seek only forfeiture of legal fees."); and *Arst v. Stifel, Nicolaus & Co.*, 954 F. Supp. 1483, 1488 (D. Kan. 1997) ("The court explained that because plaintiff was not seeking damages, he was not required to prove materiality of the nondisclosure or causation."). See also Deborah A. DeMott, *Causation in the Fiduciary Realm*, 91 B.U. L. Rev. 851, 867-68 (2011) ("In all cases, the causal standard seems a function of the remedy sought by the beneficiary, because restitutionary remedies-including forfeiture of fees otherwise due a disloyal lawyer-escape the stringency of 'but-for' causation.");

²¹² *Woods v. City Nat'l Bank & Trust Co.*, 312 U.S. 262, 268 (1941) ("Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation."); *Magruder v. Drury*, 235 U.S. 106, 120 (1914) ("While no wrong was intended, and none was in fact done to the estate, we think nevertheless that upon the principles governing the duty of a trustee, the contention that this profit could not be taken by Mr. Drury owing to his relation to the estate, should have been sustained."); *United States v. Carter*, 217 U.S. 286, 305-06 (1910) ("It would be a dangerous precedent to lay down as law that unless some affirmative fraud or loss can be shown, the agent may hold on to any secret benefit he may be able to make out of his agency."); and Bogert, *Law of Trusts & Trustees* § 484, at 343 (rev. 2d ed. 1978) quoting *People ex rel. Plugger v. Township Board of Overysse*, 11 Mich. 222, 225--226 (1863) ("Actual injury is not the principle the law proceeds on in holding such transactions void. Fidelity in the agent is what is aimed at, and as a means of securing it, the law will not permit the agent to place himself in a situation in which he may be tempted by his own private interest to disregard that of his principal.").

causation or scienter for remedies in equity.²¹³ The restatement also specifically disclaims proof of a benefit to the fiduciary which is contrary to some state law holdings, including Texas.²¹⁴

The elements of a prima facie claim in equity for breach of fiduciary duty are less rigorous than as a claim at law.²¹⁵ For remedies at law, the claimant must satisfy the normal elements of the claim as provided either in contract or tort law, including proximate cause.²¹⁶ In New York there have been at least two cases relating to legal malpractice claims that alleged that the defendant lawyers were conflicted but the claims were dismissed because the clients in those cases sought tort damages without proof of loss.²¹⁷ If those claims had been pled as claims for compensation forfeiture, they could have avoided those grounds for dismissal.

²¹³ Restatements of the Law 3d, Restitution and Unjust Enrichment 2011, § 43 a. General principles and scope (“If restitution takes the form of a liability to disgorge profits, a disloyal fiduciary—without regard to notice or fault—is treated as a conscious wrongdoer (§ 51(3)); though a defendant who obtains a benefit in consequence of another’s breach of fiduciary duty, within the rule of § 43(c), might be treated for restitution purposes as an innocent recipient (§ 50).”) See also Deborah A. DeMott, Causation in the Fiduciary Realm, 91 B.U. L. Rev. 851, 853 (2011) (“Each side of fiduciary liability also uses a distinctive vocabulary. Within restitution, a disloyal fiduciary ‘‘obtains’ or ‘‘derives’ benefits through wrongful conduct, terms that hint at causal connections[,] but do not explicitly articulate them.’’ (quoting E. Allan Farnsworth, *Your Loss or My Gain?: The Dilemma of the Disgorgement Principle in Breach of Contract*, 94 Yale L.J. 1339, 1362

²¹⁴ *Foley v. Am. Elec. Power*, 425 F. Supp.2d 863, 873 (S.D. Ohio 2006). (stating that there is “no requirement that an agent actually receive a benefit before the faithless servant doctrine authorizes a forfeiture of the agent’s compensation.”) and Restatement of the Law 3d, Restitution and Unjust Enrichment 2011, § 43 a. General principles and scope (“To this end, a liability in restitution by the rule of this section does not depend on proof either that the claimant has sustained quantifiable economic injury or that the defendant has earned a net profit from the transaction.”)

²¹⁵ Compare Restatements of the Law 3d, Restitution and Unjust Enrichment 2011, § 43 Breach of fiduciary duty (“A person who obtains a benefit (a) in breach of a fiduciary duty, (b) in breach of an equivalent duty imposed by a relation of trust and confidence, or (c) in consequence of another’s breach of such a duty, is liable in restitution to the person to whom the duty is owed.”) to *Hunn v. Dan Wilson Homes, Inc.*, 2015 U.S. App. LEXIS 10061 (5th Cir. Tex. June 15, 2015) quoting *Graham Mortg. Corp. v. Hall*, 307 S.W.3d 472, 479 (Tex. App.—Dallas 2010, no pet.) (“The elements of a breach of fiduciary duty claim are: (1) a fiduciary relationship must exist between the plaintiff and defendant; (2) the defendant must have breached his fiduciary duty to the plaintiff; and (3) the defendant’s breach must result in injury to the plaintiff or benefit to the defendant.”) See also *Williams Trading LLC v. Wells Fargo Sec., LLC*, 553 Fed. Appx. 33, 2014 U.S. App. LEXIS 1517, *35 (2d Cir. N.Y. 2014) quoting *Johnson v. Nextel Commc’ns, Inc.*, 660 F.3d 131, 138 (2d Cir. 2011) (“Turning first to Williams’s claim for breach of fiduciary duty, the elements of such a claim are: “(i) the existence of a fiduciary duty; (ii) a knowing breach of that duty; and (iii) damages resulting therefrom.”) and *Ball v. Kotter*, 723 F.3d 813, 826 (7th Cir. Ill. 2013) citing *Neade v. Portes*, 193 Ill. 2d 433 (Ill. 2000) (“To succeed in a claim for breach of fiduciary duty, a plaintiff must prove the following elements: (1) a fiduciary duty exists; (2) the fiduciary duty was breached; and (3) the breach proximately caused the injury of which the plaintiff complains.”)

²¹⁶ See note 97 on the New York causation standard.

²¹⁷ *Unger v. Paul Weiss Rifkind Wharton & Garrison*, 265 A.D.2d 156, 157 696 N.Y.S.2d 36 (N.Y. App. Div. 1st Dep’t 1999) (“The complaint was properly dismissed as against defendant law firm since an attorney’s failure to disclose a conflict of interest is not actionable absent allegations that such failure proximately caused actual damages.”) *Accord Tolmosova v. Umarova*, 961 N.Y.S.2d 362, 2012 N.Y. Misc. LEXIS 4780, **12 (2012)

The goal of remedies in equity is to deny unjust enrichment to the defendant so the principal's damages are irrelevant. For monetary remedies in equity, the principal needs to identify the object of the remedy: the assets or funds to be deemed a constructive trust; revenues or profits to be disgorged or the compensation to be forfeited. Once the principal satisfies this initial requirement, the burden shifts to the fiduciary to disprove the identification, to show which portions of the asset or revenues do not apply and what offsets, if any, should be applied.²¹⁸ The law in equity allows the burden to be shifted because it assumes that the fiduciary generally has better access to all relevant information.²¹⁹ In the case of compensation forfeiture, the principal needs to identify all applicable compensation and the period of disloyalty as outlined by the fiduciary's acts of disloyalty.²²⁰ In regard to conflicted transactions, once the principal adequately identifies the transaction, the burden shifts to the fiduciary to prove the entire fairness of the transaction.²²¹

The D.C. district court made an interesting point in the 2012 case of *Amtrak v. Veolia Transp. Services*.²²² That case related to Amtrak as an employer which alleged that a competitor aided and assisted three Amtrak employees to breach their fiduciary duty which also assisted the competitor in gaining a lucrative project that Amtrak regarded as its own opportunity. Since the employees did find employment at the competitor and the competitor did gain a project that Amtrak had planned to capture, the court held the employer does not have to prove that it

²¹⁸ *C&B Sales & Serv., Inc. v. McDonald*, 177 F.3d 384, 387 (5th Cir. 1999) (corporation had burden of establishing revenues of business done by former president in breach of his fiduciary duty, while defendant bore burden of proving his costs; a "reasonable approximation" of gain, not great specificity, is required); *In re Niles*, 106 F.3d 1456, 1461-1462 (9th Cir.1997) ("...once the principal has shown that funds have been entrusted to the fiduciary and not paid over or otherwise accounted for," fiduciary has burden to render an accounting; allocation of burden "reinforces the substantive policies behind fiduciary law by ensuring that fiduciaries will perform their obligations faithfully and with care"); *McClung v. Smith*, 870 F. Supp. 1384, 1400-1401 (E.D.Va.1994), *aff'd in part and remanded on other grounds*, 89 F.3d 829 (4th Cir.1996) (accounting places burden of proof on agent); *Clancy v. Coyne*, 244 F. Supp. 2d 894, 897-98 (N.D. Ill. 2002) ("Coyne admits to commingling a client funds account worth \$ 52,161.24. He does not contest that this account may have been attributable to the Trust. Because of this commingling, it is Coyne's burden to show that the \$ 52,161.24 was not part of the Trust's estate."); and *Wilz v. Flournoy*, 228 S.W.3d 674, 676 (Tex. 2007) ("A party seeking to impose a constructive trust has the initial burden of tracing funds to the specific property sought to be recovered. Once that burden is met, "the entire ... property will be treated as subject to the trust, except in so far as the trustee may be able to distinguish and separate that which is his own." (emphasis in original)). Generally, see *Taylor v. Meirick*, 712 F.2d 1112, 1122 (7th Cir. 1983) ("If General Motors were to steal your copyright and put it in a sales brochure, you could not just put a copy of General Motors' corporate income tax return in the record and rest your case for an award of infringer's profits.").

²¹⁹ Restatement (Third) of Restitution and Unjust Enrichment § 51 (2011) (stating that a claimant seeking disgorgement of profit has the burden of proving at least an estimate of the amount of wrongful profit)

²²⁰ *Enstar Group Inc.*, 812 F. Supp. at 1571-73 (analyzing defendant Grassgreen's acts of disloyalty over time.) and *Cameco, Inc. v. Gedicke*, 157 N.J. 504, 724 A.2d 783, 790 (1999) citing *Simulation Sys. Technologies v. Oldham*, 269 N.J. Super. 107, 111-12 (App.Div. 1993) ("The court denied recovery, however, because the evidence failed to establish the pay periods in which disloyalty had occurred or the compensation paid for those periods.")

²²¹ *Clancy v. Coyne*, 244 F. Supp. 2d 894, 897-98 (N.D. Ill. 2002) ("Coyne admits to commingling a client funds account worth \$ 52,161.24. He does not contest that this account may have been attributable to the Trust. Because of this commingling, it is Coyne's burden to show that the \$ 52,161.24 was not part of the Trust's estate.")

²²² *AMTRAK v. Veolia Transp. Servs.*, 886 F. Supp. 2d 14, 19-20 (D.D.C. 2012) citing Restatement (Third) of Restitution, sec. 51

otherwise would have gained the project.²²³ The court explained that the law assumes the causation²²⁴ but the competitor who was being sued for joint liability with the ex-employee is free to try to prove that the competitor would have gained the project even if the ex-employees had not left the employer.²²⁵ In that case, the jury found that Veolia did not proximately cause Amtrak to lose the contract and Veolia therefore overcame the assumption and disproved causation.²²⁶

It is not uncommon for a court to issue an injunction such as a disqualification order based on the fear that a fiduciary is likely to breach their fiduciary duty.²²⁷ The proverbial 'near-miss' in terms of actual damage tends to be regarded as a 'hit.' On the other hand, courts occasionally hold that a breach or act of disloyalty was insignificant or insubstantial and that the trial judge's equitable discretion includes the authority to deny any forfeiture.²²⁸

IV Forfeiture

"Most generalizations about restitution are trustworthy only so long as they are not very meaningful and meaningful only so long as they are not very trustworthy."²²⁹

²²³ See also Restatement (Third) of Restitution and Unjust Enrichment § 43 illus. 12 (2011); 2 Dan B. Dobbs, Law of Remedies, § 10.4, at 667 (2d ed. 1993) ("In cases of this sort the beneficiary of the relationship does not necessarily prove that he would have refused the contract had he been given full information. He does not even prove that the contract is disadvantageous to him or that the broker's profit was made at his expense in any sense. He merely proves the disloyalty and that is enough to operate as a defense on the contract or as grounds for restitution.").

²²⁴ AMTRAK v. Veolia Transp. Servs., 886 F. Supp. 2d 14, 18-19 (D.D.C. 2012) ("..causation is presumed as a matter of law where an attorney breaches his fiduciary duties to his client.)

²²⁵ Id. at 19-20 (D.D.C. 2012) citing Restatement (Third) of Restitution, sec. 51 ("The award of disgorgement to [sic] rests on "an implicit judgment that the claimant, rather than the wrongdoer, should . . . obtain the benefit of the favorable market conditions, acumen, or luck, as the case may be." When a court finds the profits are "the product of legitimate contributions by the defendant that should not, in justice, be awarded to the claimant," it may deny them as "too remote" to warrant disgorgement. Such conditions exist here.")

²²⁶ Id. at 18. See also Triton Const. Co., Inc. v. Eastern [**18] Shore Elec. Services, Inc., supports Veolia's argument against disgorgement. 2009 Del. Ch. LEXIS 88, *29 (Del. Ch. May 18, 2009).

²²⁷ Maritrans GP, Inc. v. Pepper, Hamilton & Scheetz, 529 Pa. 241, 260-61 602 A.2d 1277, 1992 Pa. LEXIS 36 (1992) ("Here, the trial court did not commit an abuse of discretion. On these facts, it was perfectly reasonable to conclude that Maritrans' competitive position could be irreparably injured if Pepper and Messina continued to represent their competitors and that Maritrans' remedy at law, that is their right to later seek damages, would be difficult if not impossible to sustain because of difficult problems of proof, particularly problems related to piercing what would later become a confidential relationship between their competitors and those competitors' attorneys (Pepper and Messina).")

²²⁸ See AMTRAK v. Veolia Transp. Servs., 886 F. Supp. 2d 14, 19-20 (D.D.C. 2012) citing Restatement (Third) of Restitution, sec. 51 ("When "liability for the profits so designated would be unacceptably punitive, being unnecessary to accomplish the object of the disgorgement remedy in restitution," courts may deny disgorgement, even if some level of attribution exists.") and In re Marriage of Pagano, 154 Ill. 2d 174, 190 (1992)

²²⁹ Dan B. Dobbs, Law of Remedies §4.1 (2d Ed. 1993).

A.Origins and Foundations for Forfeiture

Compensation forfeiture is sometimes equated to the faithless servant doctrine which has been traced back to two New York cases in the 1880's.²³⁰ Alternatively, the Restatement of the Law Second, Agency has been credited as a key source of supporting principles for forfeiture. Both are important but they are largely reflections of the law in equity and public policy which has been denying compensation for fiduciaries before 1600.²³¹ The law in equity on compensation forfeiture is found in fee disputes for estates or trusts in probate court,²³² in bankruptcy court hearings on compensation for all professionals²³³ and in claims against fiduciaries such as agents²³⁴ and lawyers.²³⁵

Forfeiture of a fiduciary's compensation originated in the law in equity because courts in equity were the only courts that provided jurisdiction for the claim of breach of fiduciary duty

²³⁰ See *Murray v. Beard*, 102 N.Y. 505, 7 N.E. 553, 554, 2 N.Y. St. 466 (N.Y. 1886) and *Turner v. Konwenhoven*, 100 N.Y. 115, 2 N.E. 637, 639 (N.Y. 1885)). Generally, see Charles A. Sullivan, *Mastering the Faithless Servant?: Reconciling Employment Law, Contract law, and Fiduciary Duty*, 2011 Wis. L. Rev. 777, 780 (2011); Barbara Van Arsdale, *Application of the "Faithless Servant Doctrine,"* 25 A.L.R.6th 399 (Indicating that states with two or more cases relating to the Doctrine include Illinois, Kansas, Kentucky, Massachusetts, New York, Ohio, South Carolina and West Virginia); and Joseph T. Bockwith, *Liability of Corporate Officer or Director For Commission or Compensation Received From Third Person in Connection With Corporation*, 47 ALR 3d 373

²³¹ *Silbiger v. Prudence Bonds Corp.*, 180 F.2d 917, 920-21 (2d Cir. N.Y. 1950) citing *Shire v. King*, Yelverton 32. *Anonymous*, 7 Modern 47 ("Certainly by the beginning of the Seventeenth Century it had become a commonplace that an attorney must not represent opposed interests; and the usual consequence has been that he is debarred from receiving any fee from either, no matter how successful his labors. Nor will the court hear him urge, or let him prove, that in fact the conflict of his loyalties has had no influence upon his conduct; the prohibition is absolute and the consequence is a forfeiture of all pay.")

²³² *Wolf v. Weinstein*, 372 U.S. 633, 641 (1963) citing *In re Republic Gas Corp.*, 35 F.Supp. 300, 305 ("These decisions found even in the general terms of the statute the embodiment of "ancient equity rules governing the conduct of trustees, including deprivation of compensation where there is a departure from those rules." ")

²³³ *Id.* at 641("The relevant legislative materials leave no doubt that the purpose behind § 249 was to codify the rule of these decisions and to give pervasive effect in Chapter X proceedings to the historic maxim of equity that a fiduciary may not receive compensation for services tainted by disloyalty or conflict of interest.")

²³⁴ *Shaeffer v. Blair*, 149 U.S. 248, 258 (1893) ("But it is unnecessary to express a decisive opinion upon that point, because, whether Shaeffer was acting as a partner, or only as an agent, in performing the duties required of him by the contract, the fraudulent misconduct proved against him deprived him of the right to the stipulated commissions."); *Wadsworth v. Adams*, 138 U.S. 380, 388 (1891) ("We cannot agree that such conduct upon the part of Adams was consistent with the duty he owed to his principal in virtue of his agency for the sale of the notes. He abused the confidence reposed in him, and thereby lost the right to claim the stipulated compensation of ten thousand dollars or any other sum.")

²³⁵ *Denver v. Roane*, 99 U.S. 355, 360-61(1879) ("If, then, by abandoning the case and denouncing it as fraudulent, he lost all the right which he had against Lamar, how can he claim from his copartners any of the compensation they obtained for conducting the case after his abandonment to final success? His action was a breach of his duty to those partners, as well as of his obligation to Lamar. By the agreement of co-partnership he had undertaken to share in the labor, and to promote the common interests of the firm, and that was the foundation of his right to share in its earnings."). See also note 231 *infra*.

(originally for trusts.)²³⁶ A review of the early American opinions on compensation forfeiture reveal a rationale based in public policy²³⁷ which remains a high priority for the law in equity today.²³⁸

Three main rationales have driven forfeiture. First, the agreement for the principal to pay the fiduciary has been held to be void or unenforceable once the fiduciary's disloyalty has been proven.²³⁹

²³⁶ *In re Evangelist*, 760 F.2d 27, 29 (1st Cir. 1985) (Breyer, J.) ("Actions for breach of fiduciary duty, historically speaking, are almost uniformly actions 'in equity,' carrying with them no right to trial by jury."). See also 1 Dan B. Dobbs, *Law of Remedies*, § 5.18(3), at 935 (2d ed. 1993) ("Because equity created the substantive rights against fiduciaries, equity has always taken jurisdiction in claims against them without regard to the adequacy test. ")

²³⁷ *Weil v. Neary*, 278 U.S. 160, 173-74 (1929) ("The contract is contrary to public policy -- plainly so. What is struck at in the refusal to enforce contracts of kind is not only actual evil results but their tendency to evil in other cases."); *Anderson Cotton Mills v. Royal Mfg. Co.*, 221 N.C. 500, 20 S.E.2d 818 (1942) ("In selling to itself, the defendant attempted to act in the double capacity of agent and purchaser--a combination so incompatible and noxious to the fundamental rule of loyalty demanded of an agent to his principal, acting as a fiduciary, as to be intolerable to public policy."); *Steinmetz v. Kern*, 375 Ill. 616, 621 (1941) ("An agent is entitled to compensation only on a due and faithful performance of all his duties to his principal. In the application of this rule it makes no difference whether the result of the agent's conduct is injurious to the principal or not, as the misconduct of the agent affects the contract from considerations of public policy rather than of injury to the principal.");

²³⁸ *Buckingham, Doolittle & Burroughs, L.L.P. v. Bonasera*, 157 Ohio Misc. 2d 1, 17 (Ohio C.P. 2010) ("Further, as public policy mandates, an employee cannot be compensated for his own deceit or wrongdoing."); *Evans & Luptak, PLC v. Lizza*, 251 Mich. App. 187, 193 (2002) ("Rather, defendants have simply defended a cause of action brought by plaintiff raising as a defense that the alleged contract is unethical because it violates our public policy as expressed in the Michigan Rules of Professional Conduct. We agree with defendants."); *In re Marriage of Pagano*, 154 Ill. 2d 174, 190 (1992) ("While the breach may be so egregious as to require the forfeiture of compensation by the fiduciary as a matter of public policy, such will not always be the case."); and *Moses v. McGarvey*, 614 P.2d 1363, 1372 (Alaska 1980) ("It is well established that an attorney, disqualified on conflict-of-interest grounds, generally is barred as a matter of public policy from receiving any fee from either of the opposed interests.")

²³⁹ *Wadsworth v. Adams*, 138 U.S. 380, 388-89 (1891) ("He abused the confidence reposed in him, and thereby lost the right to claim the stipulated compensation of ten thousand dollars or any other sum. "); *Plotner v. Chillson & Chillson*, 1908 OK 103, *P11 (1908) ("In either event they would be agents of plaintiff, receiving a compensation from him, and owing to him in return unswerving loyalty to his interests in the transaction. Anything short of that violated the contract existing between them and forfeited their right to compensation, whether the same was to be paid as commission when the land was bought or "net profits" when the land was sold."); *Raisin v. Clark*, 41 Md. 158, 160-61 (1874) citing *Story on Agency*, secs. 210, 211 ("Hence the law will not permit an agent of the vendor whilst that employment continues, to assume the essentially inconsistent and repugnant relation of agent for the purchaser. The rule to which we have adverted forbids the Courts to entertain an action founded upon such a contract."); *Fish v. Lester*, 69 Ill. 394, 1873 Ill. LEXIS 365, 400 (1873) ("These facts tend to show that this agent was employed to buy as well as to sell. Appellees had bargained for the skill and labor of White, their agent, and had a right to expect and demand his undivided services in their behalf and for their interest. This they have not secured, and a court of chancery will not lend its aid to enforce a contract which, in equity, is regarded as constructively fraudulent."); and *Arnold v. Brown*, 41 Mass. 89, 96-97 (1832) (holding that a conflicted transaction is of no effect because the assent of two minds is essential to a contract of sale.);

Second, loyalty of the 'servant' to one's master or of the agent to the principal is implied in the fiduciary relationship which has been held to apply as a condition precedent.²⁴⁰ That the agent or employee was present at work at all relevant times and even accomplished his assigned duties without failure was regarded as irrelevant to the later discovery of various forms of disloyalty.²⁴¹ Loyalty in and of itself is regarded as a critical component of the fiduciary's service. Without continuous loyalty the fiduciary's services are heavily discounted.²⁴²

The first two rationales would support a claim for breach of contract or the assertion that the agency contract is void under contract law²⁴³ but they do not explain why the agent's claim for

²⁴⁰ *Wadsworth v. Adams*, 138 U.S. 380, 387 (1891) ("The agreement to pay the latter ten thousand dollars, if he negotiated a sale of them at a discount of eight per cent per annum, was in consideration of his endeavoring to dispose of them upon those terms. It was a condition precedent to his right to such compensation that the services he undertook to render should be faithfully performed."); *Rockefeller v. Grabow*, 136 Idaho 637, 642 (Idaho 2001) (stating that fulfilling one's fiduciary duties is a condition precedent to compensation); *Burrow v. Arce*, 997 S.W.2d 229, 240 (Tex. 1999) quoting 1 Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* § 1.5:108 (2d ed. Supp. 1998) ("Generally speaking, where the claim rests on the disloyalty of the lawyer, and the remedy sought is forfeiture or disgorgement of fees already paid, rather than compensatory damages for poor service, the breach of the duty of loyalty is the harm, and the client is not required to prove causation or specific injury."); *Sutherland v. Guthrie*, 86 W. Va. 208, 211 (1920) quoting *Mechem on Agency* at § 1588 ("Among the other measures designed to secure the performance of this duty is the denial of compensation where the duty has not been observed; it is often said that a loyal performance is a condition precedent to the right to recover compensation, and it has been held in many cases that, where the agent is unfaithful to his trust and abuses the confidence reposed in him, he will not be entitled to any compensation for his services."); and *Plotner v. Chillson & Chillson*, 1908 OK 103, 21 Okla. 224, 230(1908)

²⁴¹ E.g. see note 297 *infra*.

²⁴² *Wolf v. Weinstein*, 372 U.S. 633, 641-42 (1963) ("Indeed, we have several times declared that the general statutory authorization in the Bankruptcy Act for "reasonable" compensation for services "necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act."); *Foley v. Am. Elec. Power*, 425 F. Supp. 2d 863, 873 (S.D. Ohio 2006) quoting *Roberto v. Brown County General Hosp.*, 59 Ohio App. 3d 84, 86 (Ohio Ct. App., Brown County 1989) ("Dishonesty and disloyalty on the part of an employee which permeates his service to his employer will deprive him of his entire agreed compensation, due to the failure of such an employee to give the stipulated consideration for the agreed compensation."); *Gemini Networks v. Nofs*, 2004 Conn. Super. LEXIS 62, 3-4 (Conn. Super. Ct. Jan. 8, 2004) quoting *Lydia Pinkham Medicine Co. v. Gove*, 303 Mass. 1, 20 N.E.2d 482, 486 (Mass. 1939) ("However, a number of courts in other states have recognized the basis for return of compensation is "not in the theory of a penalty, but in the theory that payment is not due for services not properly rendered."); *Heyman v. Kline*, 344 F. Sup. 1110, 1113-14 (D. Conn. 1970), *rev'd on other grounds*, 456 F.2d 123 (2d Cir. 1972) quoting *Breen v. Larson College*, 137 Conn. 152, 157, 75 A. 2d 39, 42 (1950) ("It has long been the law of this state that in contracts of hiring there is an implied condition that the servant will perform the duties incident to his employment honestly, and will do nothing injurious to his employer's interest, and if he proves radically unfaithful to his trust or is guilty of gross misconduct he forfeits all right to compensation.")

²⁴³ Restatement of the Law, Second, Contracts, § 178 When a Term Is Unenforceable on Grounds of Public Policy; Restatement of the Law, Second, Contracts, § 225 Effects of the Non-Occurrence Of a Condition; Restatement of the Law, Second, Contracts, § 229 Excuse of a Condition to Avoid Forfeiture; and Restatement of the Law, Second, Contracts Chapter 9 - The Scope of Contractual Obligation, Topic 5 - Conditions and Similar Events, Introductory Note ("The rules speak to the effect of the non-occurrence of a condition (§ 225), to whether an event is a condition and, if so, the nature of that event (§§ 226-28), and to the excuse of the non-occurrence of a condition to avoid forfeiture (§ 229). Where performances are to be exchanged under an exchange of promises, a failure of

quantum meruit for past services must fail unless a judge is willing to hold that an unfaithful agent's services are worthless as a matter of law. Thus the third rationale of denying unjust enrichment to an unfaithful agent is necessary to explain the normal practice of full forfeiture over the period of disloyalty.²⁴⁴

While it could be argued that forfeiture has sufficient basis in contract law to resemble a remedy at law,²⁴⁵ the stronger position remains that forfeiture is a remedy in equity that resembles disgorgement as they both share the driving rationale of denying unjust enrichment to a disloyal fiduciary which is the third rationale. The role or goal for disgorgement, however, is also mixed among compensation, punishment and deterrence.²⁴⁶ Similar in some respects to

performance by one party may have the same effect as the non-occurrence of a condition, but this matter is covered in Chapter 10 and not in this Topic.”)

²⁴⁴ *Blackburn & Co. v. Park*, 357 F.2d 525, 526-27 (2d Cir. N.Y. 1966)(“ An agent that has thus disregarded its principal's interests cannot recover for services rendered.”) and *Bryant v. Lewis*, 27 S.W.2d 604, 608 (Tex. Civ. App. - Austin 1930, writ dismissed) (affirming that unintentional conflict precludes lawyer's plea for quantum meruit). See also Charles A. Sullivan, *Mastering the Faithless Servant?: Reconciling Employment Law, Contract law, and Fiduciary Duty*, 2011 Wis. L. Rev. 777, 779 (2011) (“In contrast, under the faithless servant rule, agreed compensation otherwise earned is forfeited, 9 and, perhaps more surprisingly, the servant is denied quantum meruit recovery for the value of any faithful services he might have rendered.”)

²⁴⁵ See *Advanced Nano Coatings, Inc. v. Hanafin*, 556 Fed. Appx. 316, 318 (5th Cir. Tex. 2014)(affirming award of \$ 342,116.80 for breach of contract which amounts to 100% of the fiduciary's compensation during the period of disloyalty and the plaintiff's lost profits for breach of fiduciary duty.) and *McGowan & Co. v. Bogan*, 2015 U.S. Dist. LEXIS 68144, *37-39 (S.D. Tex. May 27, 2015)(denying defendant's motion for summary judgement against claim under Ohio law for breach of contract for lost profits, compensation for the employee during the period of disloyal competition and other out of pocket cash expenses.)

²⁴⁶ *Fair v. Bakhtiari*, 195 Cal. App. 4th 1135, 1153, 125 Cal. Rptr. 3d 765 (Cal. App. 1st Dist. 2011) (“Forfeiture has serves three purposes (1) deterrence (Law governing Lawyers, section 37), (2) prevents unjust enrichment (Woods); and (3) compensation for the decreased value of tainted representation.”); *Ulico Cas. Co. v. Wilson, Elser, Moskowitz, Edelman & Dicker*, 16 Misc. 3d 1051, 1065 (2007) quoting *Diamond v Oreamuno*, 24 NY2d 494, 498, 248 NE2d 910, 301 NYS2d 78 [1969] (“This is because the function of such an action, unlike an ordinary tort or contract case, is not merely to compensate the plaintiff for wrongs committed by the defendant but ... to prevent them, by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others, or to which their agency or trust relates.”);

punitive damages, it can punish²⁴⁷ and deter²⁴⁸ at the same time. Thus a defendant that is held liable for breach of fiduciary duty is ordered to disgorge any profits that he received that he cannot otherwise prove were not the result of his unjust acts.²⁴⁹

²⁴⁷ *Providence Rubber Co. v. Goodyear*, 76 U.S. 788, 804 (1870) ("The rule is founded in reason and justice. It compensates one party and punishes the other. It makes the wrong-doer liable for actual, not possible, gains. The controlling consideration is that he shall not profit by his wrong."); *AMTRAK v. Veolia Transp. Servs.*, 886 F. Supp. 2d 14, 19-20 (D.D.C. 2012) citing Restatement (Third) of Restitution, sec. 51 ("Disgorgement: when liability for the profits would be unacceptably punitive courts may deny disgorgement."); *Snepp v. United States*, 444 U.S. 507, 515-16 (1980) (per curiam) (explaining that constructive trust remedies "[conform] relief to the dimensions of the wrong ... since the remedy reaches only funds attributable to the breach, it cannot saddle the [fiduciary] with exemplary damages out of all proportion to [the] gain"); and *Owen v. Shelton*, 221 Va. 1051, 277 S.E.2d 189, 192 (Va. 1981) ("The purpose of the rule is more prophylactic than remedial; it is applied, not to compensate the principal for an injury, but rather to discipline the fiduciary in the conduct of the office entrusted to him.") But see *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 270 (1993) ("In crafting a remedy for a breach of trust the exclusive aim of the common-law equity courts was to make the victim whole, "endeavoring as far as possible to replace the parties in the same situation as they would have been in, if no breach of trust had been committed." Historically, punitive damages were unavailable in any equitable action on the theory that "the Court of Chancery as the Equity Court is a court of conscience and will permit only what is just and right with no element of vengeance.") and *AMTRAK v. Veolia Transp. Servs.*, 886 F. Supp. 2d 14, 19-20 (D.D.C. 2012) quoting *Estate of Corriea*, 719 A.2d 1234, 1240 (D.C.) ("The purpose of disgorgement is remedial, rather than punitive., and it "is meant to provide just compensation for the wrong, not to impose a penalty; it is given in accordance with the principles governing equity jurisdiction, not to inflict punishment but to prevent an unjust enrichment."").

²⁴⁸ *Woods v. City Nat'l Bank & Trust Co.*, 312 U.S. 262, 268 (1941) quoting *Weil v. Neary*, 278 U.S. 160, 173 (1929) ("The principle enunciated by Chief Justice Taft in a case involving a contract to split fees in violation of the bankruptcy rules, is apposite here: "What is struck at in the refusal to enforce contracts of this kind is not only actual evil results but their tendency to evil in other cases."); *United States v. Carter*, 217 U.S. 286, 305-06 (1910) ("Such an agent has the power to conceal his fraud and hide the injury done his principal. It would be a dangerous precedent to lay down as law that unless some affirmative fraud or loss can be shown, the agent may hold on to any secret benefit he may be able to make out of his agency."); *Avianca, Inc. v. Corriea*, 1992 U.S. Dist. LEXIS 4709 (D.D.C. Apr. 13, 1992) citing *In Re Eastern Sugar Antitrust Litigation*, 697 F.2d 524, 533 (3rd Cir. 1982) ("[D]isgorgement is an extraordinary remedy, and if it is ever appropriate, it should be used only in situations where the deterrence rationale is so important that only disgorgement will serve a socially useful purpose."); *Scanlan v. Eisenberg*, 669 F.3d 838, 841 (7th Cir. 2012) ("[T]he fact that disgorgement involves a claim for money does not detract from its equitable nature: in such an action, the court is not awarding damages to which plaintiff is legally entitled but is exercising the chancellor's discretion to prevent unjust enrichment."); and *Hendry v. Pelland*, 73 F.3d 397, 402 (1996) ("Forfeiture of legal fees serves several different purposes. It deters attorney misconduct, a goal worth furthering regardless of whether a particular client has been harmed.")

²⁴⁹ Similarly, the court's orders are similarly scrutinized to avoid unjust enriching the plaintiff. See Charles E. Rounds, Jr., *Relief for IP Rights Infringement is Primarily Equitable: How American Legal Education Is Short- Changing the 21st Century Corporate Litigator*, 26 Santa Clara Computer & High Tech. L.J. 313, 349 (2010) ("The court in equity is loath to fashion a remedy that leaves either party unjustly enriched.").

Compensation forfeiture operates as either a shield²⁵⁰ or a sword.²⁵¹ It appears that most of the early opinions on forfeiture relate more to the shield function which is to deny payment for fiduciary or agent compensation. This can be a two-step process in which the principal pursues self-help by terminating the relationship for cause and refusing to pay any compensation. The second step, if necessary, is for the principal to answer the fiduciary's collection action or suit for breach of contract with an affirmative defense or counterclaim for disloyalty.²⁵² UWA's forfeiture action against Aramony was as a counterclaim against Aramony's action to confirm his retire benefits which was filed four years after his termination.²⁵³ Given the statute of limits, however, the counterclaim is less effective than the affirmative defense. If the principal waits to see if the fiduciary will try to collect his compensation, the amount of forfeiture will decline as the statute applies just as it did against the UWA.

One issue that occasionally arises about compensation forfeiture is whether an award of compensation forfeiture is covered under professional liability insurance policies, especially legal malpractice policies. The issue was occasionally raised in regard to disgorgement with

²⁵⁰ *Tyco Int'l, Ltd. v. Kozlowski*, 756 F. Supp. 2d 553, 564 (S.D.N.Y. 2010) ("Even if these contracts were validly entered into, Kozlowski cannot recover on them. The "faithless servant doctrine," used as a sword in Tyco's claims, may also be used as a shield to Kozlowski's counterclaims. As a result of Kozlowski's many breaches of fiduciary duty, Tyco has no duty to honor compensation agreements made during Kozlowski's period of disloyalty.") See also *Gammon v. Henry I. Hank Hodes & Diagnostic Experts of Austin, Inc.*, 2015 Tex. App. LEXIS 4235, p*25-26 (Tex. App. Austin Apr. 24, 2015)(affirming take nothing judgment for lawyer's collection action, forfeiture of additional \$ 23,279.19 of paid lawyer's fees and denial of lawyer's claim for quantum meruit due to the breach of fiduciary duty owing to an unreasonable retainer agreement executed after representation had been initiated.)

²⁵¹ *Shoemake v. Ferrer*, 168 Wn.2d 193, 202 (2010) ("It should make no difference whether the lawsuit arises when the lawyer sues for fees and the client defends on the basis of legal malpractice or when the client brings an action for legal malpractice in the first instance.")

²⁵² *Hendry v. Pelland*, 73 F.3d 397, 403 (1996) ("Because the Hendrys presented sufficient evidence for a jury to find that Pelland violated his fiduciary duty, the district court erred in prohibiting them from using this argument as a defense to the counterclaim."); *Evans & Luptak, PLC v. Lizza*, 251 Mich. App. 187, 193 (2002) ("Rather, defendants have simply defended a cause of action brought by plaintiff raising as a defense that the alleged contract is unethical because it violates our public policy as expressed in the Michigan Rules of Professional Conduct. We agree with defendants."); *Zakibe v. Zakibe*, 28 S.W.3d 373, 2000 Mo. App. LEXIS 1224 (Mo. Ct. App. 2000) citing Restatement (Second) of Agency, Introductory Note to Chapter 13, Topic 1 ("Breach of fiduciary duty also constitutes a defense to an action by the agent against the principal for compensation for services. Because of the fiduciary relationship, fiduciary principles modify any contract between the parties. This allows the breach of fiduciary duty to give rise to claims in tort, as well as contract, and to be pleaded as a defense to a contractual claim for compensation."); *Burrow v. Arce*, 997 S.W.2d 229, 244 (Tex. 1999)(stating that one form of forfeiture is as a "defense of an agent's claim for compensation"); and *Slosberg v. Callahan Oil Co.*, 125 Conn. 651, 655 (1939)("In view of the fiduciary character of the office of president no authority is needed to support the defendant's claim. ...By the conduct described, the plaintiff forfeited any claim to compensation which might otherwise be due.)Restatement of the Law, Third, Agency (2006), § 8.01 General Fiduciary Principle d. (2). Remedies for breach of fiduciary duty--forfeiture of commissions and other compensation. ("The availability of forfeiture is not limited to its use as a defense to an agent's claim for compensation.").

²⁵³ See note 84 infra and accompanying text

mixed results but the issue relating to compensation forfeiture appears to occur more frequently and frequently against coverage.²⁵⁴

B.Damages at Law or Remedy in Equity?

Despite the merger of courts at law and courts in equity, the exact nature of a cause of action between one at law or in equity can arise especially when the parties contest the issue of the right to a jury trial or if injunctive relief is sought.²⁵⁵ For the purpose of determining whether a jury trial was required, one recent case evaluated the nature of a claim that sought three remedies (compensating damages, compensation forfeiture and punitive damages) to determine whether the gist of the relief sought was for relief in equity or at law.²⁵⁶ One rule of thumb, for example, is to consider remedies that seek strictly monetary relief as remedies at law and remedies that require specific orders or exercises of the court's *in personam* authority as remedies in equity.²⁵⁷ In *Client Funding Solutions*, the court pursued a two stage test which includes (1) the historical nature of the remedies and, more importantly, (2) the nature of the package of remedies sought. The court found the second stage indeterminate due to the strong

²⁵⁴ *Level 3 Communications, Inc. v. Federal Ins. Co.*, 272 F.3d 908, 910-11 (7th Cir. 2001) ("[A] 'loss' within the meaning of an insurance contract does not include the restoration of an ill-gotten gain... An insured incurs no loss within the meaning of the insurance contract by being compelled to return property that it had stolen, even if a more polite word than 'stolen' is used to characterize the claim for the property's return."); *John M O'Quinn P.C. v. Nat'l Union Fire Ins. Co.*, 33 F. Supp. 3d 756, 774 (S.D. Tex. 2014)(affirming arbitration panel's denial of insurance coverage because " the Court is of the opinion that the Panel's Final Award finding that the O'Quinn Firm's contingent fee contracts did not allow for the deduction of BI General Expenses and requiring them to return all BI General Expenses improperly deducted from the Class members' settlement distributions, together with prejudgment interest, attorneys' fees, and the forfeiture of \$25 million in fees received is sufficient to satisfy the "profit or advantage to which [it] was not legally entitled" exclusion.); *Burlington Ins. Co. v. Deudhara*, No. C09-00421-SBA, 2010 WL 3749301, at *11 (N.D. Cal. Sept. 23, 2010) (claims for injunctive relief and disgorgement of unlawfully collected rent sought "equitable relief [and] not ... 'damages' that can be covered by a liability policy"); *Republic Western Ins. Co. v. Spieren, Woodward, Willens, Denis & Furstman*, 68 F.3d 347, 351-52 (9th Cir. 1995) (attorney's required disgorgement to the court of fees not properly earned due to disabling conflict of interest was not "damages" for which the insurance policy required coverage); and *Haines v. St. Paul Fire & Marine Ins. Co.*, 428 F. Supp. 435, 439-41 (D. Md. 1977) (law firm's professional liability insurance did not cover SEC action seeking judgment requiring firm to disgorge attorneys' fees.)

²⁵⁵ E.g. *Design Strategy, Inc. v. Davis*, 469 F.3d 284, 299 (2d Cir. N.Y. 2006)(distinguishing claim for lost profits as legal and claim for disgorgement as equitable)

²⁵⁶ *Client Funding Solutions Corp. v. Crim*, 943 F. Supp. 2d 849, 2013 U.S. Dist. LEXIS 64488, **16-17 (N.D. Ill. 2013)

²⁵⁷ *Ibid.* quoting *Int'l Fin. Servs. Corp. v. Chromas Techs. Can., Inc.*, 356 F.3d 731, 736, 2004 U.S. App. LEXIS 1003 (7th Cir. Ill. 2004) ("As a general matter, though, legal remedies traditionally involve money damages, while "[e]quitable remedies, by contrast, are typically coercive, and are enforceable directly on the person or thing to which they are directed.") but see *Id.* at 856-57) quoting *S.E.C. v. Rind*, 991 F.2d 1486, 1493 (9th Cir. 1993) ("[T]he fact that disgorgement involves a claim for money does not detract from its equitable nature: in such an action, the court is not awarding damages to which plaintiff is legally entitled but is exercising the chancellor's discretion to prevent unjust enrichment.") Generally, see Colleen Murphy, *Misclassifying Monetary Restitution*, 55 SMU L. Rev. 1577, 1610 (2002) (a professional discussion of the terminology of restitution).

mixed nature of the remedies while the historical nature of a fiduciary claim was definitely in equity so it denied the jury trial.²⁵⁸

Compensation forfeiture is largely regarded as a remedy in equity but there is also support from contract law especially for compensation as a defense to a collection action. There is ample precedent to the effect that a conflicted transaction is void or that a representation agreement is void or has been breached by a dual agency. Outside of the context of irreparable injury, some courts have rationalized a damages approach based on the argument that if the fiduciary had complied with her duty to disclose her breach of duty, the employee would have been fired and therefore the employer has been damaged to extent of having paid wages for a disloyal fiduciary.²⁵⁹ Left unexplained is why any side benefits from the agent's endeavors are not credited.

Claims relating to bribes can be pled as either at law or in equity as it is now widely accepted that the principal can plead for the bribe as either a unjust enrichment for the employee or as a damage (the bribe being a reasonable estimate of the principal's loss from the bribery).²⁶⁰

Originally, all claims against trustees and fiduciaries were resolved in courts in equity because common law courts did not recognize trusts or trustees as independent entities.²⁶¹ By the time of Story's treatise, only trusts and trustees retained exclusive jurisdiction in equity.²⁶² Then, as

²⁵⁸ Id. at 858 quoting *Cantor v. Perelman*, 2006 U.S. Dist. LEXIS 5210, 2006 WL 318666, at *8-9 (D. Del. Feb. 10, 2006) ("In the final analysis, the court found a "mixed result" under prong two, as the breach of fiduciary duty claims sought "both legal and equitable relief." And in resolving the ultimate question of the appropriate finder of fact to resolve those claims, the court concluded that "the scales tip in favor of Plaintiffs' claims being judged equitable" because "[t]o weigh the factors differently would effectively ignore the historical factor, contrary both to the Seventh Amendment's purpose * * * and to the express holding of *Granfinanciera*, 492 U.S. at 42, that history is to be accorded weight in the balancing.")

²⁵⁹ *HTS, Inc. v. Boley*, 954 F. Supp. 2d 927, 956 (D. Ariz. 2013) quoting *Serv. Emp. Int'l Union v. Colcord*, 160 Cal. App. 4th 362, 72 Cal. Rptr.3d 763, 769 (Cal. App. 2008) ("In *Service Employees*, the court found that the employee "supported himself with compensation he received from [his employer] while he plotted against its interests. Had he resigned as soon as he embarked on competition against [his employer], or had . . . disclosed defendants' activities, [his employer] would not have continued to pay him.") and *Sunset Acres Motel, Inc. v. Jacobs*, 336 S.W.2d 473, 483 1960 Mo. LEXIS 742 (Mo. 1960)(" The theory is, perhaps, that the commission was never rightfully paid under the circumstances, that the money still belongs to the seller, and that he has been damaged to the extent of the wrongful payment.")

²⁶⁰ *Williams Elecs. Games, Inc. v. Garrity*, 366 F.3d 569, 576 (7th. Cir. 2004) ("The victim of commercial bribery can obtain either his damages or the profits that the bribe yielded. The total profits equal the amount of the bribe plus the revenues generated by the bribe minus the cost of goods sold any other variable costs incurred in making the sales."). See also 2 Dan B. Dobbs, *Law of Remedies*, § 10.6, at 700 (2d ed. 1993) ("So the cases allow recovery of the bribe amount from the briber either as restitution or as damages." (citations omitted)).

²⁶¹ See note 236 *infra*.

²⁶² See 1 JOSEPH STORY, *COMMENTARIES ON EQUITY JURISPRUDENCE, AS ADMINISTERED IN ENGLAND AND AMERICA* § 437 (Jairus W. Perry ed., 12th ed. 1877)

now, claims against non-trustee fiduciaries enjoyed concurrent jurisdiction which has been subject to the doctrine of irreparable injury since 1616 which requires the claimant that seeks jurisdiction in equity to show that her claim would be otherwise irreparably damaged without the help of a court in equity, i.e. that she would not be entitled to an adequate remedy at law for her cause of actions and particular case facts.²⁶³

Why isn't irreparability discussed more often in appellate opinions on compensation forfeiture?²⁶⁴ First, the doctrine is fading in use and has now been rejected by two restatements.²⁶⁵ Second, irreparability is much more likely to arise if injunctive relief is in dispute rather than a plea for a monetary remedy in equity.²⁶⁶ Third, the irreparable injury doctrine may not be discussed because it is so apparent that there is no alternative remedy at law for compensation forfeiture. Without an alternative, such forfeiture is therefore without an adequate remedy which should allow a court in equity to hear the plea and possibly to order that remedy.

The degree to which some court dismiss the issue of jurisdiction or authority in equity to grant the forfeiture of compensation is revealed in the 2010 opinion in *Kozlowski v. Tyco*. Judge Griesa specifically stated that he had not determined whether Tyco would suffer an irreparable injury without a remedy in equity for its claims or whether remedies at law offered Tyco an

²⁶³ Restatement of the Law, Second, Agency (1958), § 399 Remedies of Principal e. ("A principal does not have an action for an account or other equitable relief against an agent merely because of the existence of the agency relation or because the agent has received something for or from the principal. However, equitable relief may be granted not only when there is no adequate remedy at law, as where an injunction is granted, but also where there is a close fiduciary relation. If the agent is not only an agent, but also a trustee, as where he is given money to invest for the principal which he invested in his own name, an action for an accounting will ordinarily lie.")

²⁶⁴ But see *Searcy, Denney, et al. v. Scheller*, 629 So.2d 947, 951 (Fla. Dist. Ct. App. 4th Dist. 1993) (holding that the failure of the trial court to consider the adequacy of legal remedies for the breach before ordering a fee forfeiture was error.)

²⁶⁵ RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 4(2) (2011) ("A claimant otherwise entitled to a remedy for unjust enrichment, including a remedy originating in equity, need not demonstrate the inadequacy of available remedies at law."); Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 HARV. L. REV. 687, 692 (1990) ("These real reasons for denying equitable remedies are not derived from the adequacy of the legal remedy or from any general preference for damages. . . . Sometimes there are good reasons to deny legal relief and grant equitable relief instead. But there is no general presumption against equitable remedies."); Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 HARV. L. REV. 687, 690 (1990) ("The Restatement (Second) of Torts dropped the traditional version of the rule from the black letter and condemned it as misleading")

²⁶⁶ Based on prior investigation using word searches, the author found that the terms "adequate remedy" or "irreparable injury" in general were found in less than five percent of the Texas cases that used "unjust enrichment" or "constructive trust" as core-terms. In contrast, the corresponding range for injunction or mandamus is from 20% to 40%. Similar searches for all U.S. state courts showed comparable distinctions between rescission and injunction or mandamus for the last 110 years. George P. Roach, *Rescission in Texas: A Suspect Remedy*, 31 Rev. Litig. 493, 538 n.185 (2012).

adequate remedy but he felt free to grant a summary judgment motion for forfeiture of more than one hundred million dollars without any consideration of whether forfeiture is a remedy in equity or at law.²⁶⁷

The evaluation of whether a cause in action is pled as a remedy in equity or at law is frequently based on the examination of the nature of the remedy. In addition to these and other traditional considerations, more attention could be focused on the process and procedures sought by the parties to determine the nature of the cause of action:

Has the plaintiff pled that she was damaged (if not, her action can only survive as a claim in equity);

Is the plaintiff going to carry the entire burden of proof for proving damages (if the plaintiff is relying on shifting the burden of proof, her action can only survive as a remedy in equity);

Which causation standard has the plaintiff pled? Does the complaint anticipate does the plaintiff intend to meet: that of minimal or relaxed causation for remedies in equity or the normal or full causation standard for remedies at law?

Does the plaintiff intend to present ex post evidence for her remedies measure or will she rely on the ex ante standard for remedies at law?

Does the plaintiff intend to exercise its discretion under the anti-netting rule to pick and choose which breaches of duty are to be included in the ex post results and which are to be rejected and considered as ex ante losses?²⁶⁸

C. Who is A Fiduciary?

There are many fine articles on the nature of fiduciary duty and of fiduciaries in general.²⁶⁹ Professor DeMott, the Reporter for the Restatement of the Law, Third, Agency (2006) suggests

²⁶⁷ See note 158 infra.

²⁶⁸ The anti-netting is only found in remedies in equity. See George P. Roach, Counting the Beans: Unjust Enrichment and the Defendant's Overhead, 16 TEX. INTELL. PROP. L.J. 483, 523-26 (2008) (discussing the anti-netting doctrine). ("It is useful to take a "back-bearing" on applications of the anti-netting doctrine. It is an obscure doctrine in measuring unjust enrichment, yet it has appeared as a measurement rule for fiduciary claims, patents, copyrights, trademarks, trade secrets, and federal agency claims.")

²⁶⁹ See Deborah A. DeMott, Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences, 48 ARIZ. L. REV. 925, n46 (2006) Deborah A. DeMott, Disloyal Agents, 58 Ala. L. Rev. 1049 (2007) ("On the characteristics of fiduciary duties and circumstances that warrant their imposition, see Tamar Frankel,

that "the defining or determining criterion should be whether the plaintiff (or claimed beneficiary of a fiduciary duty) would be justified in expecting loyal conduct on the part of the actor and whether the actor's conduct contravened that expectation."²⁷⁰ Without pretending to do the subject adequate justice, it might be noted that other suggestions include a relationship based in trust and confidence²⁷¹ or a relationship in which the fiduciary is given authority in a consensual agreement.²⁷²

In forfeiture cases, the key dispute reduces to the applicable definition of agent as it is generally agreed that agents are fiduciaries.²⁷³ Some state courts hold that all employees are agents²⁷⁴ while other states only include officers and directors²⁷⁵ and yet a third group practice a facts

Fiduciary Duties, in 2 New Palgrave Dictionary of Economics and Law 127, 128 (1998); J.C. Shepherd, *The Law of Fiduciaries* (1981); Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 *Cornell L. Rev.* 767 (2000); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 *U. Pa. L. Rev.* 1735, 1784 n.129 (2001); Andrew Burrows, *We Do This at Common Law but That in Equity*, 22 *Oxford J.L. Stud.* 1, 8-9 (2002); Matthew Conaglen, *The Nature and Function of Fiduciary Loyalty*, 121 *L.Q. Rev.* 452 (2005); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 *Duke L.J.* 879 (1988); Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 *J.L. & Econ.* 425 (1993); Lawrence E. Mitchell, *The Death of Fiduciary Duty in Close Corporations*, 138 *U. Pa. L. Rev.* 1675, 1682-88 (1990); Ernest J. Weinrib, *The Fiduciary Obligation*, 25 *U. Toronto L.J.* 1 (1975).")

²⁷⁰ *Id.* at 936.

²⁷¹ Restatements of the Law 3d, *Restitution and Unjust Enrichment* 2011, § 43 a ("Courts in some jurisdictions distinguish fiduciary obligations in a strict sense (such as those existing between trustee and beneficiary, agent and principal, attorney and client, guardian and ward) from analogous obligations owed by persons, not technically fiduciaries, who nevertheless occupy toward others a "relation of trust and confidence" as regards the transaction in question."); *Parham v. Wendy's Co.*, 2015 U.S. Dist. LEXIS 33531, *16 (D. Mass. Mar. 17, 2015) (stating that Massachusetts law includes as fiduciaries managers and officers as well as other employees who are assigned a position of 'trust and confidence.')

²⁷² *Stearns v. McGuire*, 154 *Fed. Appx.* 70, 75 2005 U.S. App. LEXIS 24577 (10th Cir. Colo. 2005) ("We conclude that the real estate contract between McGuire and the Staffords is not a written agreement sufficient to transform Stearns from a transaction-broker into a seller's agent. Missing from that document is a manifestation of McGuire's consent for Stearns to serve as his agent."); Restatement of the Law, Third, *Agency* (2006), § 8.01 General Fiduciary Principle b. In general. ("The relationship between a principal and an agent is a fiduciary relationship. An agent assents to act subject to the principal's control and on the principal's behalf.")

²⁷³ Restatement of the Law, Third, *Agency* (2006), § 8.01 General Fiduciary Principle b. In general. ("The relationship between a principal and an agent is a fiduciary relationship.

²⁷⁴ *Eckard Brandes, Inc. v. Riley*, 338 *F.3d* 1082, 1086 (9th Cir. Haw. 2003) citing *Eaton Corp. v. Giere*, 971 *F.2d* 136, 141 (8th Cir. 1992); *Eaton Corp. v. Giere*, 971 *F.2d* 136, 141 (8th Cir. Minn. 1992), cert. denied, 121 *L. Ed.* 2d 686, 113 *S. Ct.* 814 (1992); *Regal-Benlit Corp. v. Drecoll*, 955 *F. Supp.* 849 (N.D. Ill. 1996); *Vigoro Indus. Inc. v. Cleveland Chemical of America*, 866 *F. Supp.* 1150, 1164 (E.D. Ark. 1994); *Green v. H & R Block, Inc.*, 735 *A.2d* 1039, 1051 (Md.1999); *Fryetech, Inc. v. Harris*, 46 *F. Supp.* 2d 1144, 1152 (D. Kan. 1999) citing *Bessman v. Bessman*, 214 *Kan.* 510, 519, 520 *P.2d* 1210 (1974). Generally, see Leslie Larkin Cooney, *Employee Fiduciary Duties: One Size Does Not Fit All*, 79 *Miss. L.J.* 853, 870-71 (2010)

²⁷⁵ *Utaic v. Mackeen & Bailey*, 99 *F. 3d* 645, 655 (5th Cir. 1990); *White v. Ransmeir & Spellman*, 950 *F. Supp.* 39 (D.N.H. 1996); *Efird v. Clinic of Plastic & Reconstructive Surgery, P.A.*, 147 *S.W.3d* 208, 222 (Tenn. Ct. App. 2003); *Parham v. Wendy's Co.*, 2015 U.S. Dist. LEXIS 33531, *16 (D. Mass. Mar. 17, 2015) (stating that Massachusetts law includes as fiduciaries managers and officers as well as other employees who are assigned a position of 'trust and confidence.')

and circumstances test.²⁷⁶ In a few states, all employees have fiduciary duties but they are scaled by each employee's position.²⁷⁷ In Georgia, the agency relationship is provided by statute and is created at the discretion of the employer.²⁷⁸

There is concern among some employment law scholars that a defining agents to include at will employees or rank and file employees is over-inclusive and that compensation forfeiture is too severe.²⁷⁹ There have been some cases in which forfeiture is seen as abused on the margin against non-senior employees to control the employees life away from the workplace unnecessarily on issues of second jobs²⁸⁰ or even about the employees' free speech rights.²⁸¹

²⁷⁶ *Jet Courier Serv. v. Mulei*, 771 P.2d 486, 497 (Colo. 1989) (stating that the court should consider the nature of the employment relationship, the impact or potential impact of the employee's actions on the employer's operations, and the benefit received by the employer during the period of disloyalty); *Futch v. McAllister Towing of Georgetown, Inc.*, 518 S.E.2d 591, 596-97 (S.C. 1999) (stating that in assessing compensation in forfeiture, "the nature of the employment relationship, the nature and extent of the employee's services and the breach of duty, the loss or expense caused to the employer by the breach of duty, and the value to the employer of the services properly rendered by the employee" should be taken into consideration); *E.L. Hamm & Assocs., Inc. v. Sparrow* (In re Sparrow), Case No. 02-53511-S, Chapter 7, APN 03-5060, United States Bankruptcy Court for the Eastern District of Virginia, Newport News Division, 306 B.R. 812; 2003 Bankr. LEXIS 1956, November 3, 2003, ??); *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 200 (Tex. 2002) (stating that "impossible to give a definition of the term" fiduciary duties in a way "comprehensive enough to cover all cases."); *Dalton v. Camp*, 548 S.E. 2d 704 (N.C. 2001);

²⁷⁷ *Pride Mobility Products Corp. v. Dylewski*, slip copy, 2009 WL 249356, at *18 (M.D. Pa. 2009) ("Defendants were shareholders, employees, directors, and managers of the plaintiff corporation and clearly owed the plaintiff corporation the fiduciary duties commensurate with their respective positions."); *Cameco, Inc. v. Gedicke*, 157 N.J. 504, 724 A.2d 783, 791 (1999) (stating that a director or officer has higher fiduciary duty than the employee that works on a production line.); *Regal-Beloit Corp. v. Drecoll*, 955 F. Supp. 849, 857-858 1996 U.S. Dist. LEXIS 11384 (N.D. Ill. 1996) ("Rather, all employees owe their employers a fiduciary duty of loyalty with respect to any and all matters within the scope of their agency.");

²⁷⁸ *Leslie Larkin Cooney*, *Employee Fiduciary Duties: One Size Does Not Fit All*, 79 Miss. L.J. 853, 862 (2010) note 50 GA. CODE ANN. § 10-6-1 (2008) ("Georgia statutes define the agency relationship as arising "wherever one person, expressly or by implication, authorizes another to act for him or subsequently ratifies the acts of another in his behalf."

²⁷⁹ *What Should the Proposed Restatement of Employment Law Say About Remedies?*, 16 *Empl. Rts. & Employ. Pol'y J.* 497, 508-509 (2012) ("Many scholars of employment law were surprised at the recent line of New York cases awarding employers who show employee breach of the duty of loyalty all of the employee's compensation from the onset of disloyalty - the so-called "faithless servant rule.")

²⁸⁰ Generally, see *Jill Rubery, Jill Earnshaw & Mick Marchington*, *Blurring the Boundaries to the Employment Relationship: From Single to Multi-Employer Relationships*, in *Fragmenting Work: Blurring Organizational Boundaries and Disordering Hierarchies* (Mick Marchington et al., eds., Oxford: Oxford University Press, 2005), p. 64 ("Where employees of one organization work in environments open to pressure and influence from other employers, the relevance of key notions of . . . loyalty . . . are called into question."); *Boyle, John A.*, *Surveys of Recent Developments in New Jersey Law: - Moonlighting - Employee Assistance to an Employer's Competitor, Including Formation of a Competing Business, May Breach the Employee's Duty of Loyalty and Require Forfeiture of Compensation Paid to the Employee During Periods of Disloyalty - Cameco, Inc. v. Gedicke*, 157 N.J. 504, 724 A.2d 783 (1999), 30 *Seton Hall L. Rev.* 671 (2000)

²⁸¹ *Curran v. Cousins*, 509 F.3d 36 (1st Cir. 2007) (holding an employee can violate his/her duty by discrediting the employer's name through posting messages on an internet blog); and *Grigsby v. Kane*, 250 F. Supp. 2d 453, 455 (M.D. Pa. 2003) (finding two former attorneys for Pennsylvania's Bureau of Professional Licensing and

The Food Lion case in particular is an example of the abuse of an employee's First Amendment rights.²⁸² At least three states have enacted statutes to protect employees' personal activities.²⁸³

Without the support of polling or statistics, it nevertheless seems reasonable to posit that while most employees know they should be 'loyal' to their employer and that their employer may expect them to be loyal,²⁸⁴ the vast majority of all employees, salaried and hourly, are not aware of the jeopardy they face from compensation forfeiture for violating the implied duty of loyalty. Their vulnerability for a series of foolishly disloyal acts is compounded by the fact that their employer need not prove proximate cause or the employee's intent to be disloyal. Nevertheless, it only seems reasonable to expect some minimum loyalty within the context of the employee's job description: a night watchman has a fiduciary duty to exclude intruders from the company's property and a secretary has a fiduciary duty to respect the confidentiality of the material that flows across their desk.

D. Disloyalty

The following categories of the forms of disloyalty not all-inclusive and there is substantial potential for overlapping categories.

Occupational Affairs were properly terminated for speaking out against a new quota system.) See also Konrad Lee, *Anti-Employer Blogging: Employee Breach of the Duty of Loyalty and the Procedure for Allowing Discovery of a Blogger's Identity Before Service of Process Is Effected*, 2006 DUKE L. & TECH REV. 2, 11 (2006); Tory A. Weigand, *Employee Duty of Loyalty and the Doctrine of Forfeiture*, 42 Boston Bar Journal 6, 7 September/October, 1998 ("By definition, the reach of the duty is not limited to trade secrets or transactional transgressions, but encompasses any conduct of the employee which is inconsistent with the interest of the employer. As such, the potential expanse of the duty's reach remains uncharted. "); Laura DiBiase, *To Blog or Not to Blog?*, AM. BANKR. INST. J., Nov. 24, 2005, at 32; and Aaron Kirkland, *"You Got Fired? On Your Day Off?!"*: Challenging Termination of Employees for Personal Blogging Practices, 75 UMKC L. REV. 545 (2006).

²⁸² *Food Lion, Inc. v. Capital Cities/ABC, Inc.*, 951 F. Supp. 1224 (M.D.N.C. 1996) (holding that the grocery store chain had stated a cause of action for disloyalty against television reporters who surreptitiously gained employment to the chain to gather evidence for a planned expose on the chain's poor meat packing practices). But see *Dalton v. Camp*, 548 S.E. 2d 704, 709 (N.C. 2001) (holding that not all employees are deemed to be fiduciaries and objecting to the holding in *Food Lion*.)

²⁸³ Colo. Rev. Stat. Ann. § 24-34-402.5 (West 1990) (forbidding an employer from firing "any employee due to that employee's engaging in any lawful activity off the premises of the employer during nonworking hours"); N.Y. Lab. Law § 201-d(2)(c) (McKinney 2003) (restricting employer termination for an employee's "legal recreational activities outside work hours"); N.D. Cent. Code § 14-02.4-03 (2005) (forbidding discrimination based on an employee's lawful off-duty activities)

²⁸⁴ This may be sufficient to under Professor DeMott's definition to justify a fiduciary relation. See note 270 and accompanying text.

Conflicts A conflicted fiduciary could mean any of the following: when a fiduciary represents two principals without their informed consent (“dual representation”);²⁸⁵ when a fiduciary, generally a sales agent agrees to split fees or commissions with the agent for an opposing interest (“split fees”);²⁸⁶ when a fiduciary agrees to represent a new client that would conflict with her representation of an existing or prior client (“new client”)²⁸⁷ and when a fiduciary enters into a business transaction with the principal after the fiduciary has assumed her role as fiduciary.²⁸⁸

The traditional position on conflicted transactions was that conflicted transactions did not occur because any sale takes two parties.²⁸⁹ Similarly, courts would hold that retainer agreements for conflicted fiduciaries were unenforceable due to public policy.²⁹⁰ Normally,

²⁸⁵ *Wolf v. Weinstein*, 372 U.S. 633, 641-42 (1963) (“The relevant legislative materials leave no doubt that the purpose behind § 249 was to codify the rule of these decisions and to give pervasive effect in Chapter X proceedings to the historic maxim of equity that a fiduciary may not receive compensation for services tainted by disloyalty or conflict of interest.”); *So v. Suchanek*, 670 F.3d 1304, 1310 (2012) citing D.C. Rules of Prof'l Conduct R. 1.7 cmt. 7 (holding that the conflict is total because an objective observer would have had reasonable doubt about her ability to provide joint representation without limitation from the start.); *Stearns v. McGuire*, 154 Fed. Appx. 70, 74-75, 2005 U.S. App. LEXIS 24577 (10th Cir. Colo. 2005) citing *Moore & Co. v. T-A-L-L, Inc.*, 792 P.2d 794, 800 n.8 (Colo. 1990); *Kingsley Assoc., Inc. v. Del-Met, Inc.*, 918 F.2d 1277, (6th Cir. Mich. 1990) citing *Sweeney & Moore, Inc. v. Chapman*, 295 Mich. 360, 363, 294 N.W. 711, 712-13 (1940) (“the law will not permit an agent to act in a dual capacity in which his interest conflicts with his duty, without a full disclosure of the facts to his principal.”);

²⁸⁶ *Weil v. Neary*, 278 U.S. 160, 173-74 (1929) (“Relevant rules regarding fee splitting were adopted only after the contract was signed and were deemed inapplicable... The contract is contrary to public policy -- plainly so. What is struck at in the refusal to enforce contracts of this kind is not only actual evil results but their tendency to evil in other cases”) and *Evans & Luptak, PLC v. Lizza*, 251 Mich. App. 187, 195 (2002) citing *Abrams v. Feldstein*, 456 Mich. 867; 569 N.W.2d 160 (1997) (holding that a contract that provides for a fee-splitting arrangement is unethical and unenforceable.) But see note 298 infra.

²⁸⁷ *Price Waicukauski & Riley, LLC v. Murray*, 2014 U.S. Dist. LEXIS 130680, *41 (S.D. Ind. Sept. 18, 2014) (The court found that while the lawyer should have secured the first client's consent to representation of the second client but no conflict was applicable because the client failed to plead for breach of fiduciary duty.); *Newton v. Newton*, 2011 IL App (1st) 090683, 955 N.E.2d 572, 586 (2011) citing *King v. King*, 52 Ill. App. 3d 749, 753, (1977) (ordering the forfeiture of fees from an attorney that was first consulted briefly by the ex-husband and later retained by the ex-wife to sue on a complaint for separate maintenance.)

²⁸⁸ *Fair v. Bakhtiari*, 195 Cal. App. 4th 1135, 1152-53 (Cal. App. 1st Dist. 2011) (stating that “such transactions are always scrutinized by courts with jealous care, and are set aside at the mere instance of the client, unless the attorney can show by extrinsic evidence that his client acted with full knowledge of all the facts connected with such transaction, and fully understood their effect; and in any attempt by the attorney to enforce an agreement on the part of the client growing out of such transaction, the burden of proof is always upon the attorney to show that the dealing was fair and just, and that the client was fully advised.”)

²⁸⁹ *Arnold v. Brown*, 41 Mass. 89, 96-97 (1832) (“The assent of two minds is essential to the contract of sale, as well as to every other contract. Hence the action of one person can never change the ownership of property.”)

²⁹⁰ *Weil v. Neary*, 278 U.S. 160, 173-74 (1929) (“Enforcement of such contracts when actual evil does not follow would destroy the safeguards of the law and lessen the prevention of abuses.”); *Fish v. Leser*, 69 Ill. 394, 1873 Ill. LEXIS 365, 400 (1873) (holding that a conflicted contract is unenforceable); *Youngman v. DeSoto* (In re DeSoto), 2010 Bankr. LEXIS 4497, *13-14 (Bankr. D.N.J. Dec. 7, 2010) citing *Woods v. City National Bank & Trust Co.*, 312 U.S. 262, 85 L. Ed. 820, 61 S. Ct. 493 (1941) (“The basic principles set forth by Justice Douglas, himself a bankruptcy

courts of equity will not hear the complaints of claimants that are determined to have acted outside public policy.²⁹¹

State courts generally take one of two positions: the fiduciary must forfeit all fees from the first client²⁹² or the fiduciary must forfeit the fees from both clients.²⁹³ There have been a few exceptions²⁹⁴ and a distinction is made between potential conflicts and actual or direct conflicts.²⁹⁵

The new client conflict claims is an area of the law in which cases focus on preventing damage or deterring possible breaches of confidentiality. Injunctive relief is awarded to clients of lawyers if the judge concludes that the lawyer's representation of a second client would

expert, in have remained largely unchanged for nearly seven decades. ...Actual conflicting interests are barred and nothing further must be shown to support a complete denial of compensation."

²⁹¹ Andrew Kull, *Restitution's Outlaws*, 78 Chi.-Kent L. Rev. 17, 18 (2003) ("Restitution does not punish, but it punishes negatively: not by imposing liability on disfavored parties, nor by enhancing the liability to which disfavored parties are subject, but by denying a restitutionary claim (or counterclaim) to which the disfavored party would otherwise be entitled.")

²⁹² *Eriks v. Denver*, 118 Wn.2d 451, 824 P.2d 1207, 1992 Wash. LEXIS 45 (1992) quoting *Woods v. City Nat'l Bank & Trust Co.*, 312 U.S. 262, 268-69 (1941) ("Where [an attorney] . . . was serving more than one master or was subject to conflicting interests, he should be denied compensation. It is no answer to say that fraud or unfairness were not shown to have resulted. . . ."); *Easley v. Brookline Trust Co.*, 256 S.W.2d 983, 989 (Tex.Civ.App. Amarillo 1952, no writ)

²⁹³ *Moses v. McGarvey*, 614 P.2d 1363, 1372 (Alaska 1980); *Jensen v. Bowen*, 37 N.D. 352, 357-58 (N.D. 1917) quoting 4 R. C. L. 329 ("The rule is one of public policy. The rule is intended to be not only remedial of actual wrong, but preventive of the possibility of it. . . ."); *Plotner v. Chillson & Chillson*, 1908 OK 103, 21 Okla. 224, 230 (1908) quoting *Rice v. Wood*, 113 Mass. 133, 18 Am. Rep. 459 9 ("A broker acting for both parties in effecting an exchange of property can recover compensation from neither, unless his double employment was known and assented to by both."); *Strong v. International Bldg., Loan & Inv. Union*, 183 Ill. 97, 101-102 (1899);

²⁹⁴ *Garrick v. Weaver*, 888 F.2d 687, 691-92 (10th Cir. N.M. 1989) citing *Ross v. Scannell*, 97 Wash. 2d 598, 647 P.2d 1004, 1010-11 (1982) (en banc) (awarding quantum meruit to lawyer despite the fact that the lawyer failed to notify client of a conflict that violated the retainer agreement and professional rules.); *N. H. & H. R. Co.*, 567 F.2d 166, 175 (2d Cir. Conn. 1977) ("Woods' recognition of the general rule, however, does not strike us as a mandatory requirement that reorganization courts woodenly must deny compensation in every case of conflict of interest, regardless of the facts.");

²⁹⁵ *Rodriguez v. Disner*, 688 F.3d 645, 655 (9th Cir. Cal. 2012) ("We are not aware, however, of any California case that has overturned a trial court's decision to deny attorneys' fees to an attorney engaged in dual representation of clients with actual conflicts of interest, rather than a potential one as in *Pringle*"); *Frank Settelmeyer & Sons, Inc. v. Smith & Harmer, Ltd.*, 124 Nev. 1206, 1217-18 (2008) citing *Bottoms v. Stapleton*, 706 N.W.2d 411, 417 (Iowa 2005) ("We are persuaded by the Supreme Court of Iowa's reasoning in *Bottoms v. Stapleton*, 706 N.W.2d 411, 417 (Iowa 2005), which concluded that the district court abused its discretion in disqualifying an attorney from representing a corporation and its majority shareholder in a dissolution action because no actual conflict of interest existed, and under a rule similar to RPC 1.7(a), only an actual conflict of interest will justify disqualification—the suggestion of a potential conflict of interest is not sufficient.")

significantly jeopardize the first client's confidential information. If so, the injunction is issued to disqualify the lawyer.²⁹⁶

Just as the plaintiff is not required to prove damages, the benefits of the defendant's services are not generally considered relevant to the issue of liability or the possibility of apportionment²⁹⁷ except, apparently, when they are relevant.²⁹⁸

Disloyal competition. The disloyalty of the fiduciary competing with the principal (without the principal's knowledge and waiver) might otherwise be called disloyal competition.²⁹⁹ There are two key issues to this disloyalty. Most state courts hold that an employee is entitled to prepare to compete but she can't actual start to compete before she is off the payroll, including contacting customers to arrange for them to change vendors. *Eckard Brandes* was notable because employees without titles the employer's confidential information bid and secured a new contract while still employed for a company that competed for that same contract.³⁰⁰

²⁹⁶ *Maritrans GP, Inc. v. Pepper, Hamilton & Scheetz*, 529 Pa. 241, 255 (1992) quoting *United States v. RMI Co.*, 467 F.Supp. 915, 923 (W.D.Pa.1979)(" [a] court may restrain conduct which it feels may develop into a breach of ethics; it 'is not bound to sit back and wait for a probability to ripen into a certainty.")

²⁹⁷ *United States v. Schilling (In re Big Rivers Elec. Corp.)*, 355 F.3d 415, 437 (6th Cir. Ky. 2004)(" No doubt the sanction in this case is a harsh and unforgiving one. Schilling's efforts, he claims, brought approximately \$ 145 million of new value into the estate. Rather than the thanks of a grateful court and the thanks of grateful parties, he received an order to reimburse the debtor nearly \$ 1 million in fees. Steep as the sanction may be, it represents the price of disloyalty, a price the courts have not hesitated to charge in dealing with similar breaches of trust.")

²⁹⁸ See *Allapattah Servs. v. Exxon Corp.*, 454 F. Supp. 2d 1185, 1238 2006 U.S. Dist. LEXIS 45702, **156 (S.D. Fla. 2006)(Holding that lawyer's fee splitting agreement does not warrant full forfeiture, reducing the fee incentive award by 25% and denying disproportionate incentive award, because lawyer was instrumental in case.); In re *Austrian & German Bank Holocaust Litig.*, 317 F.3d 91, 105 2003 U.S. App. LEXIS 31, **42 (2d Cir. N.Y. 2003)(" There is not the slightest indication that any of the Class Counsel who were engaged in this enormously complicated undertaking acted with anything less than the utmost good faith. They achieved extraordinarily beneficial results for their clients. To whatever extent their representation of the Austrian Settlement Class placed them in a position of potential conflict, they have thus far not even applied to the District Court for any compensation for that representation. In sum, no basis exists for obliging counsel for the Austrian Settlement Class to forfeit the fees awarded to them by the German Foundation for their efforts, in cooperation with many other lawyers, to achieve an extraordinary extrajudicial remedy for victims of the Holocaust.")

²⁹⁹ See Appendix 1 for the remedies awarded for the following three disloyal competition cases: *HTS, Inc. v. Boley*, 954 F. Supp. 2d 927, 956 2013 U.S. Dist. LEXIS 93323 (D. Ariz. 2013); *Vibra-Tech Eng'rs, Inc. v. Kavalek*, 849 F. Supp. 2d 462, 467 (D.N.J. 2012); and *Dowd & Dowd, Ltd. v. Gleason*, 211 Ill. 2d 573, 823 N.E.2d 964, 2004 Ill. LEXIS 1607, ***41 (2004).

³⁰⁰ *Eckard Brandes, Inc. v. Riley*, 338 F.3d 1082, 1086 (9th Cir. Haw. 2003 ("Although an employee "is entitled to make arrangements to compete" with his employer prior to terminating the employment relationship, the employee is not "entitled to solicit customers for such rival business before the end of his employment."). See also *Wenzel v. Hopper & Galliher, P.C.*, 830 N.E.2d 996, 1001 (Ind. Ct. App. 2005) (The court found the following email message that was sent while the employee was still employed by the claimant as evidence of disloyal competition "As I indicated [in a previous conversation with the client], [my new firm] has agreed that I can continue to provide legal services to NCB at my current rates and under the same terms. Once you have had a chance to review this information, please feel free to call if you have any questions or comments.") *Efird v. Clinic of Plastic &*

Recently, the Second Circuit had occasion to hold that diverting business from one's employer to a competitor is the same as disloyal competition.³⁰¹

The second issue relates to measuring damages or the employee's unjust enrichment. In some cases the employee's customers are distinguished between customers that did not do business with the employer and those that did. The damage measure for new customers is profits from that customer until the employee left the employer which damages or disgorgement would continue after that departure for customers that shifted from the employer to the employee.³⁰² Note that some employment scholars have objected to the inclusion of all employees for this type of employee, citing *Berry v. Goodyear Tire* in which an hourly worker at a tire store was forced to forfeit his income from his moonlighting for a competitor.³⁰³ In that case, the defendant took paid medical leave (which was not substantiated by a doctor) and conducted

Reconstructive Surgery, P.A., 147 S.W.3d 208, 220 (Tenn. Ct. App. 2003)(awarding defendant's profit and two months of compensation forfeiture for competing with his employer before his termination.); *Vigneau v. Engineers*, 1995 Conn. Super. LEXIS 3361, *23 (Conn. Super. Ct. Dec. 4, 1995)(In a case that awarded substantial legal fees and punitive damages for another claim, the court awarded compensating damages for profits lost from the employee's competition against his employer for two projects but the court denied compensation forfeiture due to the isolated nature of the competition.); *Prince, Yeates & Geldzahler v. Young*, 2004 UT 26, P*24, 94 P.3d 179, 185 (2004) (holding that the law associate must disgorge the billings from the clients he billed while still in the employ of the claimant but denied compensation forfeiture.);

³⁰¹ *Design Strategy, Inc. v Davis*, 469 F3d 284, 300-302 (2006) (holding that the employee's compensation should be forfeited for diverting potential business to his employer's competitor just as if the employee were competing with his employer.); disloyalty for diverted profits or opportunities: "even where the profits or benefits accrue to a third party, whether or not it is under the control of the [employee]."). For a special exception see *Johnson v. Brewer & Pritchard, PC*, 73 S.W.3d 193, 197 (Tex. 2002) ("We hold only that an associate may participate in referring a client or potential client to a lawyer or firm other than his or her employer without violating a fiduciary duty to that employer as long as the associate receives no benefit, compensation, or other gain as a result of the referral.")

³⁰² *NCMIC Fin. Corp. v. Artino*, 638 F. Supp. 2d 1042, 1084 (S.D. Iowa 2009) citing *C Plus Nw., Inc. v. DeGroot*, 534 F. Supp. 2d 937, 949-50 (S.D. Iowa 2008) (applying Iowa law) ("When a disloyal employee breaches his fiduciary duty to his employer by diverting business to the employer's competitors, the employer can recover damages for diverted current business, diverted future business, and misappropriated assets."); *V.I.M. Recyclers, L.P. v. Magner*, 2005 U.S. Dist. LEXIS 47961, *60 (N.D. Ill. July 21, 2005)(" Plaintiff VIM is entitled to lost profits during Magner's employment at VIM and for two years thereafter relating to the diverted Sealed Air, U.S. Gypsum, Olmarc, and Harris Lamps accounts, the Sealed Air's Holyoke, Massachusetts and Saddle Brook, New Jersey locations and repayment of commissions and compensation earned by Magner beginning May 1, 2001 until his employment ended. Prejudgment interest shall apply to damages related to lost profits and forfeiture of wages. Due to the nature of Magner's actions, VIM is also entitled to punitive damages from Magner and Industrecycle in the amount of \$ 75,000."); and *Vendo Co. v. Stover*, 58 Ill.2d 289, 311-314 (1974)(awarding total damages of \$ 7,345,000 that includes \$ 2,135,000 of lost profits; \$ 170,835 of compensation forfeiture; and \$ 5,039,165 of lost value of the employer's enterprise.)

³⁰³ *Berry v. Goodyear Tire and Rubber Co.*, 270 S.C. 489, 492 242 S.E. (2d) 551 (1978) (A sales employee with nineteen years of service at a tire outlet took a paid medical leave of absence, during which he failed to substantiate his medical condition. The employer eventually determined that the employee was working for a competitor tire outlet on the phone at his home. The court found that the employee's actions were disloyal and "We conclude that respondent's admitted breach of duty to Goodyear disqualified him from any right he may have had to "release pay" compensation.")

business for a competitor to his employer. The court did not address a claim for forfeiture but it did confirm that the employee of nineteen years of service had been terminated for cause and was not entitled to normal termination benefits.³⁰⁴

This is an area of disloyalty in which other remedies in equity are more prevalent such as injunction, rescission and constructive trust which in many cases is due to difficulties in measuring actual damages or actual benefits³⁰⁵ or due to the need to pursue an accounting.³⁰⁶ Based only on personal experience, this is also an area in which companies are reluctant to explore and expose causation issues in public court about existing or potential clients, let alone to ask those clients to testify about why they chose one competitor over the other.

Self-dealing. The traditional case involves real estate agents or brokers who act for the principal to buy or sell property. The net effect is for the disloyal fiduciary to hide the real seller or buyer, creating an intermediary shell, and to arrange for the principal to pay too much or sell for too little to the shell which 'flips' the property to make a profit from the transaction with the hidden seller or buyer.³⁰⁷ As these actions also constitute failure to disclose important information, this would qualify as fraud or constructive fraud.³⁰⁸ The standard remedy is for the court to disgorge the profit and the fee (almost always the entire fee without

³⁰⁴ *Id.*

³⁰⁵ *Ennis v. Interstate Distribs., Inc.*, 598 S.W.2d 903, 906 (Tex. Civ. App. - Dallas 1980, no writ) (holding that, despite the fact that damages could not be determined because the buyer could not reasonably measure damages, rescission for breach of contract was proper even though the service contract was partially fulfilled); *Harry R. Defler Corp. v. Kleeman*, 19 A.D.2d 396, 403 (N.Y. App. Div. 4th Dep't 1963)(For the disloyalty of misappropriating trade secrets and competing with the employer, the court ordered three years of injunctive relief, an accounting to determine damages and forfeiture);

³⁰⁶ *Chernow v. Reyes*, 239 N.J. Super. 201, 205-206 570 A.2d 1282, (App.Div. 1990) citing Restatement, Agency 2d, § 403 at 246 (1958)(" Defendant and his corporation are liable for any profits earned in a competitive business while he was employed by plaintiff... The agent holds such profits in a constructive trust for the principal."); *Maritime Fish Products, Inc. v. World-Wide Fish Products, Inc.*, 100 A.D.2d 81, 91 (N.Y. App. Div. 1st Dep't 1984)(" Thus, an accounting is warranted to ascertain the damages resulting from Christensen's diversion of business during the entire 14-month period from December, 1975, when he incorporated World-Wide, until February 11, 1977, when he resigned from Maritime.")

³⁰⁷ *Ellison v. Alley*, 842 S.W.2d 605, 607-608 (Tenn. 1992) ("We are in agreement with the finding of breach of fiduciary duty and the award to the plaintiff of the defendant's profits. But, on the narrow issue upon which this appeal was granted, we find that the defendants are not entitled to a commission on the sale of the Ellison property. It is apparent that the defendants manipulated both the Myers and Ellison transactions in such a manner as to willfully, and wrongfully, conceal their true role and their intention to reap a \$ 180,000 ill-gained profit from the sale of the property.") and *Collins v. McClurg*, 1 Colo. App. 348, 353 (1892)

³⁰⁸ *Shaeffer v. Blair*, 149 U.S. 248, 13 S. Ct. 856, 37 L. Ed. 721, 1893 U.S. LEXIS 2290 (1893)(" Upon discovery of this fraud it was held that he would have to account for the money so advanced in excess of the amounts actually paid for property purchased, and also that because of his conduct in this regard he would not be entitled to receive the five per cent commissions stipulated to be paid him for his services.")

apportionment).³⁰⁹ The disloyal profit to the transaction may be either gross or net of necessary expenses to complete the transaction.³¹⁰

Secret profit. A secret profit is generally any undisclosed profit or benefit for the fiduciary.³¹¹ It would include but is not limited to bribes.³¹² But for accepted business practice, the frequent flyer miles that we get for employer travel could be included in this category.

Duty to disclose. The duty to disclose is complicated only because it overlaps with all of the other forms of disloyalty, i.e. if the agent accrues a secret profit, she has duty to disclose the profit and to disgorge the profit.³¹³ This is of particular import to cases which claim legal malpractice and breach of fiduciary duty when the principal claims that the breach of the other duty is legal malpractice and the failure to disclose is a breach of fiduciary duty.³¹⁴

³⁰⁹ *Ibid.*

³¹⁰ *Anderson Cotton Mills v. Royal Mfg. Co.*, 221 N.C. 500, 509 (1942) (holding that the measure of the fiduciary's profits should allow deductions for cleaning and thereby improving the value of the cotton waste at issue.)

³¹¹ *Tomsic v. Lautieri* (In re Tri-Star Techs. Co.), 257 B.R. 629, 2001 Bankr. LEXIS 47, **14-15 (Bankr. D. Mass. 2001); *Arst v. Stifel, Nicolaus & Co.*, 954 F. Supp. 1483, 1491 1997 U.S. Dist. LEXIS 1167 (D. Kan. 1997) (In a case that awarded both the secret profit and compensation forfeiture, the court explained that because of the "high standard" of loyalty established by Kansas courts, the faithless servant doctrine would not be limited to "the blatant misappropriation of funds."); *Rodgers v. Lenox Hill Hosp.*, 239 A.D.2d 140, 147 (N.Y. App. Div. 1st Dep't 1997) ("Apart from a contractual basis for recovery, "an employee who makes a profit or receives a benefit in connection with transactions conducted by him on behalf of his employer is under a duty to give such profit or benefit to his employer, whether or not it was received by the employee in violation of his duty of loyalty."); *Tarnowski v. Resop*, 236 Minn. 33, 36 (1952)(stating that "all profits made by an agent in the course of an agency belong to the principal, whether they are the fruits of performance or the violation of an agent's duty, is firmly established and universally recognized."); *Sutherland v. Guthrie*, 86 W. Va. 208, (1920) ("These authorities and the many others there cited by the courts in support of their opinions clearly establish the proposition of law that if the sale in this case had been consummated, and the plaintiffs had secured the seventeen hundred dollars of secret profits in addition to the compensation provided in their contract, they would not be allowed to retain the same, but would have to account to their principal for it.")

³¹² See note 260 *infra*.

³¹³ *Nichols v. Minnick*, 885 N.E.2d 1, 5 (Ind. 2008) ("Although we agree that there is no proof of loss to support tort damages, we do not agree with the trial court's conclusion that disgorgement is not required. The trial court based its judgment on its finding that Nichols had reason to know of the relationship between Minnick and Blickensdorf, and its conclusion that Minnick's failure to disclose the \$ 15,000 loan for the down payment "was not a serious violation of a duty of loyalty or seriously disobedient conduct such that Minnick should be ordered to repay the commission he received to Nichols." As explained above, a fiduciary is required to disgorge any benefit from failure to disclose material information. The trial court's conclusion is inconsistent with its findings of breach of fiduciary duty and materiality.") and *Boston Children's Heart Found., Inc. v. Nadal-Ginard*, 73 F.3d 429, 443 (1st Cir. 1996)(affirming forfeiture of three years of compensation and benefits because the defendant set his own salary but failed to inform his board of directors that he was employed and compensated significantly by another medical institution.)

³¹⁴ *Gibson v. Ellis*, 126 S.W.3d 324, 331 (Tex. App. - Dallas 2004, no pet.) ("Again, even assuming Gibson's legal assertions are true, the evidence did not conclusively establish the omissions were made for the purposes of achieving an improper benefit from Ellis's representation of Gibson.")

In the Grassgreen case, it was shown that the duty to disclose was applied to extend the disloyalty period beyond the time interval in which the defendants committed the disloyal transactions.³¹⁵ Under that approach, the disloyalty period would be the time in between the act of disloyalty and the date that the principal finally found out about that disloyalty.

Confidentiality. Almost 100 years ago when the concept of property rights to trade secrets was new and controversial, Justice Holmes stated that while the property rights issue might be in doubt, the betrayal of the malefactor's relationship with his employer was not and that disloyalty should be the basis for the claim.³¹⁶ This is an area in which the courts are sometimes inclined to issue injunctive relief to remove the defendant's temptation to breach her principal's confidentiality. Therefore the Pennsylvania Court issued an injunction to disqualify a lawyer from representing a competitor of the lawyer's former client even though no evidence was introduced that the lawyer had actually breach the former client's confidentiality.³¹⁷

There was a case related to a lawyer's breach of client confidentiality that apparently failed the test for sufficient egregiousness, appropriately styled Sealed Party v. Sealed Party.³¹⁸ The client was in a delicate dispute with his customer and went to lengths to ensure confidentiality in hopes of minimizing embarrassment and disruption to the relationship. The successful

³¹⁵ See note 16 and accompanying text.

³¹⁶ E. I. Du Pont de Nemours Powder Co. v. Masland, 244 U.S. 100, 102 (1917) ("Whether the plaintiffs have any valuable secret or not the defendant knows the facts, whatever they are, through a special confidence that he accepted. The property may be denied but the confidence cannot be. Therefore the starting point for the present matter is not property or due process of law, but that the defendant stood in confidential relations with the plaintiffs, or one of them. These have given place to hostility, and the first thing to be made sure of is that the defendant shall not fraudulently abuse the trust reposed in him.") See also the early insider trading cases: Oberly v. Kirby, 592 A.2d 445, 463 (Del. 1991) ("It is an act of disloyalty for a fiduciary to profit personally from the use of information secured in a confidential relationship, even if such profit or advantage is not gained at the expense of the fiduciary. The result is nonetheless one of unjust enrichment which will not be countenanced by a Court of Equity.") and Diamond v. Oreamuno, 24 N.Y.2d 494, 497-98 (1969) ("The primary concern, in a case such as this, is not to determine whether the corporation has been damaged but to decide, as between the corporation and the defendants, who has a higher claim to the proceeds derived from the exploitation of the information.")

³¹⁷ Maritrans GP, Inc. v. Pepper, Hamilton & Scheetz, 529 Pa. 241, 260 602 A.2d 1277, 1992 Pa. LEXIS 36 (1992) citing Bowman v. Bowman, 153 Ind. 498, 55 N.E. 422 (1899) (But situations may well exist where the danger of revelation of the confidences of a former client is so great that injunctive relief is warranted. This is one of those situations. There is a substantial relationship here between Pepper and Messina's former representation of Maritrans and their current representation of Maritrans' competitors such that the injunctive relief granted here was justified. It might be theoretically possible to argue that Pepper and Messina should merely be enjoined from revealing the confidential material they have acquired from Maritrans but such an injunction would be difficult, if not impossible, to administer."); Henderson v. Rep Tech, Inc., 162 A.D.2d 1028, 557 N.Y.S.2d 224, 225(N.Y. App. Div. 4th Dep't 1990) ("Consequently, the remedies of forfeiture, and permanent injunction, and the dismissal of plaintiff's claims were proper... The compensation paid an employee during the period of disloyalty is a component of the profit for which an employee must account and is subject to forfeiture."); and see note 296 infra and accompanying text.

³¹⁸ Sealed Party v. Sealed Party, Civil Action No. 04-2229, 2006 U.S. Dist. LEXIS 28392 (S.D. Tex. May 4, 2006)

settlement of the dispute included a specific confidentiality agreement between the parties and their attorneys. A law partner who was only tangentially involved in the actual litigation, however, made a press release touting the firm's success and naming the parties. The judge's opinion is noteworthy in holding that finding the lawyer liable for breach of fiduciary duty was a sufficient remedy without forfeiture. It demonstrates the changes introduced by the Restatement (Third) of the Law Governing Lawyers which is to reverse the tradition of shifting burdens of proof to assigning that burden exclusively to the plaintiff³¹⁹ and to introduce the condition that the breach be 'clear and serious' which in this case appears lost in abstraction.³²⁰ However, The Sealed Party case does confirm the principle that duty of confidentiality obtains beyond the actual attorney client relationship.³²¹

Billing practices. The courts of some states do differ about claims relating to professional billing practices or expense reimbursement fraud.³²² Presumably the difference is one of degree, i.e.

³¹⁹ Id. at *82-83 ("Based upon the foregoing findings of fact and conclusions of law, the Court holds that the Client has proven by a preponderance of the evidence that the Attorney had a continuing fiduciary duty not to reveal confidential information to others, and that the Attorney violated that duty by issuing the Press Release. The Client, however, has not proven he suffered actual damages, if he even preserved the right to claim the damages he now seeks in this case. Nor has the Client proven that the Attorney benefitted financially or otherwise from the breach of fiduciary duty. The Court also concludes no fee forfeiture is warranted because the Court cannot conclude as to any single component of the Press Release that the Attorney's breach of fiduciary duty was both clear and serious. The Client therefore has failed to establish all the elements of a breach of fiduciary duty claim against the Attorney under Texas law.")

³²⁰ Id. at 80-81("On balance, the Court cannot conclude that any component of the Attorney's violation of his fiduciary duty of continued confidentiality was both clear and serious. Some of the disclosures constitute a clear but not serious violations of fiduciary duty, and some amounted to serious but not clear violations. In the exercise of the Court's broad discretion, the Court concludes that the public interest in maintaining the integrity of attorney-client relationships is served by the conclusions herein that the Attorney breached a fiduciary duty to the Client, but not ordering a forfeiture.")

³²¹ See also *Lerner Corp. v. Three Winthrop Props., Inc.*, 124 Md. App. 679, 690 723 A.2d 560, 1999 Md. App. LEXIS 20 (1999) quoting Restatement (Second) of Agency, § 396 ("Unless otherwise agreed, after the termination of the agency, the agent: "(d) has a duty to the principal not to take advantage of a still subsisting confidential relation created during the prior agency relation."); *Graham Mortg. Corp. v. Hall*, 307 S.W.3d 472, 479 (Tex. App.—Dallas 2010, no pet.). Fiduciary duties generally terminate at the end of an employment relationship, but an "agent has a duty after the termination of the agency not to use or to disclose to third persons . . . trade secrets . . . or other similar confidential matters . . ." *NCH Corp. v. Broyles*, 749 F.2d 247, 254 (5th Cir. 1985) (second and third alterations in original) (internal quotation marks omitted).

³²² *Mar Oil, S.A. v. Morrissey*, 982 F.2d 830, 840 (2d Cir. 1993) (in a case where an attorney overcharged his client by several hundred thousand dollars and received payment by making unauthorized withdrawals of over \$ 900,000 from a trustee account, the Court held that the attorney was not required to disgorge his entire fee because, under New York law, attorneys "may be entitled to recover for their services, even if they have breached their fiduciary obligations"); *Newman v. Silver*, 553 F. Supp. 485, 496 (S.D.N.Y. 1982), *aff'd* in pertinent part, remanded in part on other grounds, 713 F.2d 14 (2d Cir., 1983) (attorney who unconscionably overcharged his client and thereby breached his fiduciary duty nevertheless is entitled to the fair value of services rendered); *Gemini Networks v. Nofs*, 2004 Conn. Super. LEXIS 62, 4-5 (Conn. Super. Ct. Jan. 8, 2004) quoting *Phoenix Mutual Life Insurance Co. v. Holloway*, 51 Conn. 310, 314 (1883)(" In the instant case this court believes the defendant's testimony to the effect that the inaccurate requests for reimbursement for expenses were the result of miscommunication with his

the minimum amount required for the court to hold the billing or expense practice as sufficiently fraudulent to constitute disloyalty. Of course the only difficulty would be in securing the award of forfeiture because the bill or expense discrepancy would be reimbursed, regardless of amount.

In *Gemini Networks*, the court may also have been less predisposed to find disloyalty in light of the disparity of the forfeiture sought (\$ 654,635) in comparison to the amount overbilled (\$ 31,861).³²³

E. Compensation

Forfeiture in this area of the law is limited to compensation which includes wages, bonuses, retirement benefits and grants of stock or stock options. If the court also grants the claimant a constructive trust, forfeiture of stock or stock options would allow the claimant to trace the proceeds of the stock or stock options if they are sold or exercised and reinvested in another investment that has appreciated.³²⁴

In a couple of cases, the court considered the defendant's expense reimbursements as compensation such as a partner's leasehold improvements to her office or elaborate parties or trips.³²⁵ To distinguish between appropriate expenses and disguised forms of compensation,

secretary or improper billings by the hotel. They were not acts of fraud or bad faith and the defendant was not "radically unfaithful to his trust or guilty of gross misconduct."); *Lerner Corp. v. Three Winthrop Props., Inc.*, 124 Md. App. 679, 692 (1999) citing *Fairfax Savings v. Weinberg & Green*, 112 Md. App. 587, 627-28, 685 A.2d 1189 (1996) (stating that excess billing in another case does not trigger compensation forfeiture.). But see *Nimkoff Rosenfeld & Schechter, LLP v. RKO Props., Ltd.*, 2011 U.S. Dist. LEXIS 22895, *7 (S.D.N.Y. Mar. 4, 2011) ("Accordingly, RKO's allegations that Nimkoff engaged in verbal abuse and physical threats, charged an excessive fee, breached confidences, and asserted a lien on client funds to which they were not entitled, sound in breach of fiduciary duty. Amendment is therefore not futile with respect to RKO's counterclaim for breach of fiduciary duty."); *Riverwalk CY Hotel Partners, Ltd.*, 391 S.W.3d at 239 (holding that the client was entitled to file a separate breach of duty claim for unfair billing practices); and *Sullivan v. Bickel & Brewer*, 943 S.W.2d 477, 483 (Tex. App. - Dallas 1995, writ denied) (affirming that the plaintiff properly alleged a claim for fraudulent billing practices that was separate from the legal malpractice claim, which was otherwise denied for limitations).

³²³ *Gemini Networks v. Nofs*, 2004 Conn. Super. LEXIS 62, 1-2 (Conn. Super. Ct. Jan. 8, 2004)

³²⁴ The claimant would have her option to accept the ex ante value of the stock or stock options on the date of the breach or its value as of the date of trial. See *Grassgreen*

³²⁵ *Dowd & Dowd, Ltd. v. Gleason*, 352 Ill. App. 3d 365, 385 (Ill. App. Ct. 2004) (While the court ordered forfeiture for some expense account items, it did not include the costs of the trip to Bermuda or the Allstate lawyers' section Christmas party because "there is no way to determine whether or not the GMS firm benefitted from those matters, or if Plaintiff would have had them in any event, even if it had known that Gleason was leaving.") and *Heyman v. Kline*, 344 F. Sup. 1110, 1115 (D. Conn. 1970), rev'd on other grounds, 456 F.2d 123 (2d Cir. 1972) (stating that the compensation to be forfeited is broadly defined to include money paid to or spent directly for the employee's benefit, including personal expenses reimbursed by the employer.)

the court will usually apply a test borrowed from trust law which is to evaluate whether the expenditure benefited the principal.³²⁶

One of the unusual forms of compensation forfeiture occurred in Phansalker in which the employee was an executive at a private merchant bank.³²⁷ As a part of his compensation, the executive was offered opportunities to invest on the same terms as the firm. Because of his failing to disclose six distinct instances of secret profit, his firm fired him and denied him the stock that he had previously elected to purchase and which had greatly appreciated to a profit of more than \$ 4 million. Upon appeal to the Second Circuit, the firm was awarded specific restitution of that stock (a remedy in equity) just as Enstar was granted specific restitution of Grassgreen's holdings in MacPherson. In general, remedies in equity can be very effective for plaintiffs who seek the return of assets that have appreciated in value between the date of the tort and the date of the trial.³²⁸

Forfeiture is an unusual form of a remedy in equity because it does not allow for counter-restitution or offsets for necessary expenses or revenue passed through to another party. For example, if a principal sued a business operation for breach of fiduciary duty and disloyalty and sought the remedy of disgorgement, the defendant's enrichment would be measured as profit not gross fees. The defendant fiduciary business would normally be allowed to offset its revenue with expenditures that benefited the principal which might include payroll for support staff and out of pocket expenses. Likely the salary of the particular fiduciary, however, would probably be held as not deductible as an 'infringing expense.'³²⁹

There is a long tradition behind the allowance of counter-restitution relating to the tradition in equity of concern for the total equity of its orders and holdings.³³⁰ Thus it is just as important

³²⁶ Dowd & Dowd, Ltd. v. Gleason, 352 Ill. App. 3d 365, 385 (Ill. App. Ct. 2004)

³²⁷ Phansalkar v. Andersen Weinroth & Co., L.P., 344 F.3d 184, 203-204 (2d Cir. N.Y. 2003) ("Here, Phansalkar acted in a manner inconsistent with his agency by withholding from AW cash, stocks, and other interests that belonged to AW and that should have been turned over to the firm, as a part of the firm's only reliable source of income. He also acted in a manner inconsistent with his agency by specifically declining Sync's offer to place an AW designee on its Board, without having told AW of the opportunity. In addition, he repeatedly violated his affirmative duty to give AW the Directors' Compensation he received on AW's behalf. These breaches are more than sufficient to warrant forfeiture.")

³²⁸ See note 204 infra.

³²⁹ See section V. C. Infringing Expenses in George P. Roach, Counting the Beans: Unjust Enrichment and the Defendant's Overhead, 16 TEX. INTELL. PROP. L.J. 483, 520 (2008)

³³⁰ See Charles E. Rounds, Jr., Relief for IP Rights Infringement is Primarily Equitable: How American Legal Education Is Short-Changing the 21st Century Corporate Litigator, 26 Santa Clara Computer & High Tech. L.J. 313, 349 (2010) ("Whether it is the case of the trustee of an express trust who has engaged in unauthorized self-dealing or the proprietary remedial constructive trustee of someone else's IP rights, this equitable right of indemnity is grounded in Equity's contribution to the law of unjust enrichment, specifically the equitable right of counter-restitution. The court in equity is loath to fashion a remedy that leaves either party unjustly enriched.").

to the law in equity that neither party to a suit be unjustly enriched, i.e. no order for a remedy in equity should enrich the plaintiff. Richard Scruschy raised this issue and asserted that it was inequitable for the trial court to award forfeiture of his gross income rather than income net of all applicable taxes. The Alabama Supreme Court's response was unsympathetic.³³¹

The absence of counter-restitution, however, raises the real specter of a punitive remedy in equity because the defendant is forced to disgorge a sum greater than her profit or gain. As the U.S. Supreme Court said in *Snepp*, disgorgement of profit cannot be punitive because the remedy is limited to profit.³³² Similarly, forfeiture of gross compensation when the defendant has used part of that compensation to pay income and other taxes begins to depart from the Court's zone of safe disgorgement.

F.Apportionment

Assuming that the fiduciary or employee has been proven to have engaged in at least some disloyalty, the next most significant issue is how the identified compensation should be allocated between forfeiture for disloyalty or excluded as not 'tainted by the disloyal acts.' According to the Restatement of the Law, Second, Agency, apportionment starts with the retainer agreement or employment contract. If the agreement provides for payment by time period or by task, then the apportionment, if any, must be consistent with the contract.³³³ So if the employee is a salesman and is paid by commission, he will need to forfeit commissions only

³³¹ *Scruschy v. Tucker*, 955 So. 2d 988, 1012 (Ala. 2006) ("We find no merit to this argument. Scruschy was credited with the gross amount, and HealthSouth was concomitantly deprived of the amount paid to Scruschy in bonuses, regardless of whether Scruschy paid a certain percentage of those funds in taxes. Whether Scruschy can obtain a refund of the taxes paid upon his restitution of the bonuses is a matter between Scruschy and the taxing authorities.") For more context on Richard Scruschy, see Section V A.

³³² See note 182 *infra*.

³³³ *G.K. Alan Assoc., Inc. v. Lazzari*, 44 A.D.3d 95, 104 (N.Y. App. Div. 2d Dep't 2007) quoting Restatement [Second] of Agency § 456 ("Nevertheless, the principal is obligated to pay to the agent, despite the breach, "the agreed compensation for services properly rendered for which the compensation is apportioned in the contract, whether or not the agent's breach is wilful and deliberate" (Restatement [Second] of Agency § 456). Under the Restatement view, therefore, "the agent is entitled to retain compensation only for properly performed tasks for which compensation is specifically apportioned by contract" (*Interpool Ltd. v. Patterson*, 874 F Supp 616, 621 [1995])."); *Hartford Elevator, Inc. v. Lauer*, 94 Wis. 2d 571, 583 (Wis. 1980) quoting Sec. 456 of the Restatement (Second) of Agency (1957) Sec. 456. Revocation for Breach of Contract or Renunciation in Breach of Contract, Comments; *Heyman v. Kline*, 344 F. Sup. 1110, 1115 (D. Conn. 1970), *rev'd on other grounds*, 456 F.2d 123 (2d Cir. 1972)(" On the basis of the test outlined in Sections 469 and 456 of the Restatement of Agency, the plaintiffs should recover all compensation given to defendant within the terms of the various employment contracts.");

on accounts or sales that were tainted by the disloyalty.³³⁴ Since the predominate agreement is to pay by the week or fortnight or month, most forfeiture is undertaken by time period, forfeiting compensation only after the first act of disloyalty.³³⁵

There is also a group of cases which distinguishes between various pieces of the employee's compensation. Thus the Second Circuit affirmed the district court's holding that forfeited the employee's salary but not the employee's commissions which were found to have been untainted by disloyalty.³³⁶ There was also a case in Illinois in which the employer bank sought nine years of forfeiture against an employee convicted of embezzlement but was limited to forfeiture of the employee's bonuses.³³⁷

The position of a state's courts on apportionment is rarely absolute and defies precise characterization without review of every opinion and some scoring system to compare idiosyncratic fact patterns. Three opinions have been found, however, that do establish three states in a seemingly firm classification. Two of those opinions reversed a trial court for failing to award full forfeiture over the period of disloyalty for a claim in which disloyalty was found to be substantial.³³⁸ By that standard, New York and Indiana are firmly characterized as favoring or expecting full forfeiture in the absence of unusual circumstances. In Idaho, the state Supreme Court remanded a trial court opinion in which the judge stated that he had to award full forfeiture and showed no consideration of what the Supreme Court deems relevant or important factors.³³⁹ So Idaho should be classified as a state in which the trial courts have to consider apportionment and justify their conclusion based on a number of factors. Those three states might be said to establish a continuum of flexibility for assessing apportionment.

³³⁴ National Legal Research Group v. Lathan, 1994 U.S. App. LEXIS 33568, *7 (4th Cir. Va. Nov. 30, 1994) citing Jackson v. Pleasanton, 101 Va. 282, 43 S.E. 573 (1903) ("The district court's decision allows Lathan to retain only commissions he received for customer sales that were not tainted by his disloyalty and that benefitted NLRG.")

³³⁵ For an interesting exception that forfeited compensation that was paid before the period of disloyalty, see Dowd & Dowd, Ltd. v. Gleason, 352 Ill. App. 3d 365, 386, 816 N.E.2d 754 (Ill. App. Ct. 2004) ("Although the bonuses were based in part on work performed antecedent to the period of breach (established here as beginning on August 7, 1990), they were properly included in the damages award in that the departing partners had already contemplated and discussed leaving the firm by the time the bonuses were voted upon. Nonetheless, they did not notify the firm of their intentions until after both bonuses had been issued. Because the bonuses issued here appear to be based on both past performance and as an inducement to perform well in the future, we cannot say that it was an abuse of discretion for defendants to have to forfeit those amounts.)

³³⁶ Design Strategy, Inc. v Davis, 469 F3d 284, 301 (2006)

³³⁷ See notes 352 to 354 *infra* and accompanying text.

³³⁸ See also note 313 *infra* on Indiana and note 134 *infra* and accompanying text on the New York standard.

³³⁹ Rockefeller v. Grabow, 136 Idaho 637, 643 (Idaho 2001) (holding that in Idaho compensation forfeiture is a flexible opinion and that the case must be remanded because the trial judge indicated no consideration of the factors relevant to possible apportionment.)

Subject to the author's limited sample of all state cases and the belief that most states' courts will eventually manifest some flexibility in light of the broad equitable discretion accorded most courts in equity,³⁴⁰

Other states that would be expected to be similar to Indiana and New York would include Kansas,³⁴¹ Ohio³⁴² and Alabama.³⁴³

States such as Idaho and Texas rely on Restatement of the Law 3d, The Law Governing Lawyers that list specific factors that should be considered for forfeiture.³⁴⁴

³⁴⁰ Id. at 639 quoting *Burrow v. Arce*, 997 S.W.2d 241 (1999) ("The Burrow Court found that "to require an agent to forfeit all compensation for every breach of fiduciary duty, or even every serious breach, would deprive the remedy of its equitable nature.")

³⁴¹ *Bessman v. Bessman*, 214 Kan. 510, 520 P.2d 1210, 1974 Kan. LEXIS 369 (1974) ("The emphasized language, referring to services for which no compensation has been "apportioned," is in line with the New York and Minnesota cases discussed above. Thus a minor breach of duty, affecting only a single transaction, will not result in loss of compensation attributable and "apportioned" to other transactions properly carried out. On a temporal basis, a defalcation in one month will not necessarily cause a forfeiture of compensation for other months when services are performed in an unexceptionable manner. This is the concept denoted by the New York rule that the faithlessness must "permeate" the service to cause a total loss of compensation, and of the restaters' criteria for exercising judicial discretion in allowing or denying compensation to a trustee.) and *Wellwin Drilling Corp. v. Rush*, 1998 Kan. App. Unpub. LEXIS 524, *17-18 (Kan. Ct. App. Sept. 4, 1998) ("In *Bessman*, 214 Kan. at 522, the Supreme Court recognized that an unfaithful officer could be forced to forfeit his entire salary, but only if his unfaithfulness permeated all of his services for the corporation. Based upon the lack of detail regarding the scope of *Wellwin's* operations, it is impossible to tell, as a matter of law, whether *Rush's* unfaithfulness permeated his entire employment. Accordingly, the trier of fact must ascertain what compensation *Rush* should be required to forfeit as a result of his breach of fiduciary duties.")

³⁴² *Buckingham, Doolittle & Burroughs, L.L.P. v. Bonasera*, 157 Ohio Misc. 2d 1, 17 (Ohio C.P. 2010) quoting *Dowd & Dowd Ltd. v. Gleeson*, 352 Ill.App.3d, 365, 385, (App.2004) ("In this context of a departing lawyer, Illinois has applied the rule that "permits a complete forfeiture of any salary paid by a corporation to its fiduciary during a time when the fiduciary was breaching his duty to the corporation." Indiana and New York have applied similar rules in departing-lawyer cases as well."); *Roberto v. Brown County General Hosp.*, 59 Ohio App. 3d 84, 86 (Ohio Ct. App., Brown County 1989) ("Accordingly, the court adopts the "faithless servant doctrine" enunciated by the Kansas Supreme Court in *Bessman v. Bessman* (1974), 214 Kan. 510, 520 P. 2d 1210. The "faithless servant doctrine" in *Bessman*, supra, holds that dishonesty and disloyalty on the part of an employee which permeates his service to his employer will deprive him of his entire agreed compensation, due to the failure of such an employee to give the stipulated consideration for the agreed compensation. Further, as public policy mandates, an employee cannot be compensated for his own deceit or wrongdoing. However, an employee's compensation will be denied only during his period of faithlessness.")

³⁴³ *Shaffer v. Regions Fin. Corp.*, 29 So. 3d 872, 883-884 2009 Ala. LEXIS 193 (Ala. 2009) citing *Edwards v. Allied Home Mortgage Capital Corp.*, 962 So. 2d 194 (Ala. 2007) ("The Restatement (Second) of the Law of Agency § 469 (1958) describes the doctrine: "'An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a wilful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned.'")

³⁴⁴ *Dernick Res., Inc. v. Wilstein*, 2015 Tex. App. LEXIS 6684, *29 (Tex. App. Houston 1st Dist. June 30, 2015) quoting *ERI Consulting Eng'rs, Inc. v. Swinnea*, 318 S.W.3d 867, 875 (Tex. 2010) ("The remedy of forfeiture must fit the

Wisconsin³⁴⁵ and Massachusetts³⁴⁶ have already been identified as providing the fiduciary the opportunity to prove offsets to forfeiture based on proving the value of the fiduciary's services. Sometimes this seems to reduce the issue to whether the employee spent a normal amount of time and effort on the job, producing for the company.³⁴⁷ At other times, the courts have effectively shifted the burden to the employer, holding that the employer's failure to disprove the employee's value differed from the compensation warranted no forfeiture.³⁴⁸

circumstances presented. Swinnea, 318 S.W.3d at 874. The trial court should consider factors such as the gravity and timing of the breach, the level of intent or fault, whether the principal received any benefit from the fiduciary despite the breach, the centrality of the breach to the scope of the fiduciary relationship, any other threatened or actual harm to the principal, the adequacy of other remedies, and whether forfeiture "fit[s] the circumstances and work[s] to serve the ultimate goal of protecting relationships of trust.") and Rockefeller v. Grabow, 136 Idaho 637,643 (Idaho 2001) quoting Burrow v. Arce, 997 S.W.2d 229,241-43 (1999) (...the Texas Supreme Court rejected the theory of automatic full forfeiture. The Burrow Court found that "to require an agent to forfeit all compensation for every breach of fiduciary duty, or even every serious breach, would deprive the remedy of its equitable nature." Instead, the Court held that Texas law requires a consideration of several factors in determining the amount of forfeiture, including: "the gravity and timing of the violation, its willfulness, its effect on the value of the [agent's] work for the [principal], and other threatened or actual harm to the [principal] and the adequacy of other remedies."....In making its determination, the trial judge should consider factors including: the seriousness and timing of the violation; the willfulness of the breach; the potential for, or actual harm to the principal; and whether the agent completed a divisible portion of his contract duties before the breach occurred for which compensation can be determined.")

³⁴⁵ Hartford Elevator, Inc. v. Lauer, 94 Wis. 2d 571, 586 (Wis. 1980) Town Plan & Eng. Assoc. Inc. v. Amesbury Spec. Co. Inc., 369 Mass. 737, 342 N.E.2d 706, 711 (1971) ("We conclude that whether the agent should be denied all or any part of his compensation during the period in which he breached his duty of loyalty depends on consideration and evaluation of all the circumstances, including the nature of the employee's services and breach of duty; the detriment to the employee if he is deprived of compensation; loss, expenses and inconvenience caused to the employer by the employee's breach; and the value to the employer of the services properly rendered by the employee.")

³⁴⁶ Meehan v. Shaughnessy, 404 Mass. 419, 440(1989) ("Parker Coulter fails to consider, however, that a fiduciary may be required "to repay only that portion of his compensation, if any, that was in excess of the worth of his services to his employer." Chelsea Indus., supra. Here, the judge found that throughout the period in question the MBC attorneys worked as hard, and were as productive as they had always been. This finding was warranted, and is unchallenged by Parker Coulter. In these circumstances, we conclude that the value of the MBC attorneys' services was equal to their compensation. Parker Coulter, therefore, is not entitled to this relief.")

³⁴⁷Orkin Exterminating Co. v. Rathje, 72 F.3d 206, 208 (1st Cir. Mass. 1995) ("Because of the court's finding that defendant's energies were diverted away from his responsibilities to Orkin, and given the burden on him to prove the value of his services, the court's finding that he was worth everything Orkin paid him is very hard to credit.") and Milwaukee Precision Casting, Inc. v. Bebee, 224 Wis. 2d 641, 590 N.W.2d 281, 1999 Wisc. App. LEXIS 10, 27 (Wis. Ct. App. 1999) ("Consequently, without his successfully completing his MPC tasks, MPC would not have enjoyed the success it did. Thus, Bebee's work contributed to the company's significant billings. Finally, the damages already assessed against Bebee will reimburse the company for its losses. Thus, in applying the Hartford Elevator test, a return of Bebee's salary to MPC would result in "an unjust deprivation" to Bebee, and an unjust enrichment to MPC. Thus, we conclude that requiring Bebee to return his salary would be unfair and we affirm the trial court's decision to exclude the salary of Bebee in the damages awarded to MPC.)

³⁴⁸ Tomsic v. Lautieri (In re Tri-Star Techs. Co.), 257 B.R. 629, 637 (Bankr. D. Mass. 2001) ("There is no evidence before this Court which would denigrate the value of the services that Lautieri, Sr. rendered to the Debtor, nor was

The policy of the courts in Illinois is one of the most difficult to characterize. Illinois courts have issued a number of forceful opinions on compensation forfeiture especially from its supreme court that suggest a policy similar to that of Indiana or New York.³⁴⁹ Such an inference is contradicted by *Pagano* which emphasized the need for flexibility in apportionment judgments from Illinois courts³⁵⁰ and *Pagano* was one of two or three Illinois opinions which denied any forfeiture for cases in which disloyalty was substantial.³⁵¹ As a result of this equitable discretion there are opinions that limit forfeiture to bonuses in addition to actual damages of \$799,395.64 based on embezzlement and fraud.³⁵² In his opinion, the federal district judge implied disdain for compensation forfeiture in general or at least as claimed in that case.³⁵³ In addition to complete restitution for the embezzlement, the bank sought nine years of forfeiture of salary and benefits.³⁵⁴

it the testimony of Downes that his dismissal of Lautieri, Sr. had anything to do with the quality of his services to the Debtor. This Court finds that the value of Lautieri, Sr.'s services to the Debtor was more or less equivalent to his salary.")

³⁴⁹ *Vendo Co. v. Stoner*, 58 Ill. 2d 289, 314 (1974) ("It borders upon the frivolous for defendants to claim a right to retain the compensation which the judgment restored to plaintiff.") and *Dowd & Dowd, Ltd. v. Gleason*, 211 Ill. 2d 573, 823 N.E.2d 964, 2004 Ill. LEXIS 1607, ***41 (2004) citing *Levy v. Markal Sales Corp.*, 268 Ill. App. 3d 355, 373, (1994) ("Illinois law permits a complete forfeiture of any salary paid by a corporation to its fiduciary during a time when the fiduciary was breaching his duty to the corporation. Though there was no indication that defendants did not work at the efficiency level or with the diligence that they had prior to deciding to leave Dowd, they cannot claim a right to retain the compensation earned while breaching their fiduciary duty to Dowd.")

³⁵⁰ *In re Marriage of Pagano*, 154 Ill. 2d 174, 190 (1992)("As these and many other cases demonstrate, when one breaches a fiduciary duty to a principal the appropriate remedy is within the equitable discretion of the court. While the breach may be so egregious as to require the forfeiture of compensation by the fiduciary as a matter of public policy, such will not always be the case. Punitive damages are permissible where a duty based on a relationship of trust is violated, the fraud is gross, or malice or willfulness are shown; such an award is not automatic.")

³⁵¹ *Clinton Imperial China, Inc. v. Lippert Mktg., Ltd.*, 377 Ill. App. 3d 474, 482 (Ill. App. Ct. 1st Dist. 2007) ("Before the breaches, Marketing had already performed the most essential part of its duties by bringing Potteries and Chef together. Under these circumstances the trial court found insufficient grounds for forfeiture. We cannot say that the trial court abused its discretion."); *Gaffney v. Harmon*, 405 Ill. 273,281 (1950) and *Oil, Inc. v. Martin*, 381 Ill. 11 (1942)

³⁵² *Bank of Tokyo-Mitsubishi, Ltd. v. Malhotra*, 131 F. Supp. 2d 959, 962 (N.D. Ill. 2000) ("But what is not called for is the extraordinarily punitive required repayment of Vinay's total compensation and related fringe benefits.")

³⁵³ *Id.* at 961.("That same analysis does not however extend to Bank's effort to mulct Vinay in additional damages of a wholly punitive nature by forcing him to disgorge the entire sum of more than a half-million dollars that he had received as compensation and fringe benefits during his nine years of employment by Bank. There are to be sure a number of Illinois cases that uphold such forfeiture in cases that involve breaches of fiduciary duty, but Bank's counsel are guilty of overstatement in attempting to convert that doctrine from a discretionary one to a mandated result.")

³⁵⁴ *Id.* at 961.

The New Jersey Supreme Court stated in the Cameco opinion that the egregiousness of the fiduciary's disloyalty can have an impact on the apportionment opinion of the trial judge.³⁵⁵ This observation applies widely in courts of most states. An example of this phenomenon is sometimes taken from the New York case of William Floyd Union Free School District. In that case, it was determined that the former treasurer of the school had rigged the payment system to report him as retired for the purposes of receiving retirement benefits between April 4, 2000, and January 24, 2003 despite the fact that he was still actively working for the system and receiving a salary. The trial judge's declared that the plaintiff school district was relieved of its obligation to pay the defendant's retirement benefits for a period of 10 years.³⁵⁶ On appeal, the trial court was instructed to modify the order such that the school district was permanently relieved to pay any insurance benefits.³⁵⁷

Note that it is not unusual for courts to misunderstand the standard for forfeiture in section 469 of the Restatement of the Law, Second, Agency which refers to 'wilful and deliberate breach of his contract of service.'³⁵⁸ Comment b of that section equates a 'serious violation of a duty of loyalty' to such a willful and deliberate breach.³⁵⁹

G.Stacking the Remedies

The widespread award of compensation forfeiture has made it commonplace to find packages of remedies for breach of fiduciary duty. A package of two remedies is common and combinations of three or more remedies are not rare. The Grassgreen included six remedies (compensating damages, consequential damages, constructive trust, specific

³⁵⁵ Cameco, Inc. v. Gedicke, 157 N.J. 504, 521 (1999) ("Thus, the egregiousness of the employee's conduct may affect the employer's right to withhold or recoup the employee's compensation. If the employee directly competes with the employer, aids the employer's direct competitors or those with interests adverse to the employer's interests, participates in a plan to destroy the employer's business, or secretly deprives the employer of an economic opportunity, the employee may forfeit the right to compensation.")

³⁵⁶ William Floyd Union Free School Dist. v. Wright, 61 A.D.3d 856, 857 (N.Y. App. Div. 2d Dep't 2009)

³⁵⁷ Id. at 877.

³⁵⁸ Restatement of the Law, Second, Agency,(1958) § 469 Disloyalty or Insubordination as Defense ("An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a wilful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned.")

³⁵⁹ Id. at cmt. b ("A serious violation of a duty of loyalty or seriously disobedient conduct is a wilful and deliberate breach of the contract of service by the agent, and, in accordance with the rule stated in Section 456, the agent thereby loses his right to obtain compensation for prior services, compensation for which has not been apportioned.")

restitution, compensation forfeiture and punitive damages.³⁶⁰ Appendix 1 compares the remedy packages for the four cases in Section II and seven other cases. It shows that compensation forfeiture can equal or exceed the amount of compensating and consequential damages and that the ratio of the sum of compensation forfeiture and punitive damages to total damages has ranged from 1% to 89% with a simple average of 66% for the ten cases.³⁶¹

It is only reasonable to expect that some trial judges will perceive the remedy as excessive damages or as excessive in that case. The trial judge in *Bildman* is a typical example; if she had been allowed to exercise her unfettered discretion, she would not have awarded any forfeiture or punitive damages even though the egregious factor would seem high.³⁶² Equitable discretion includes the right to deny disgorgement when it appears inequitable.³⁶³

It seems clear that the intended result of a legal process that allows compensation forfeiture and punitive damages to be awarded is the financial ruin of the defendant. How many people today even among the highest paid have sufficient reserves to undergo expensive litigation, to pay substantial compensating or consequential damages as well as punitive damages and then also to pay back to the employer three to five years of past gross compensation? It seems very unlikely that Aramony, Bildman or Gittlitz survived the payment of their judgments without financial ruin. Grassgreen might be the only exception.

Perhaps the punishment is appropriate for felons that steal large amounts of money and do not generally spend much time in jail. The only problem is that a process that willingly adopts such a punitive result (perhaps not in any individual case but as a consistent result overall) does not belong in a court of equity which traditionally eschewed punitive damages.³⁶⁴

H.Non-Forfeiture Clauses

³⁶⁰ See Appendix I or the discussion in section II A.

³⁶¹ See Appendix I.

³⁶² See note 136 and accompanying text. See additional examples in note 320 *infra* and notes 352 to 354 *infra* and accompanying text. See also *Price Waicukauski & Riley, LLC v. Murray*, 47 F. Supp. 3d 810, 2014 U.S. Dist. LEXIS 130680, **42-43 (S.D. Ind. 2014) ("Professor Tidmarsh opined that PWR should have obtained written consent for the dual representation of the Murrays and the plaintiffs in the Russell action. While the Court agrees that this may have been the most prudent course of action, in all, the Court does not see any equity in disgorging PWR of \$2.7 million in attorney fees for failing to do so.")

³⁶³ See note 228 *infra* [Amtrak]

³⁶⁴ See *Tull v. United States*, 481 U.S. 412, 422 (1987) ("Remedies intended to punish culpable individuals ... were issued by courts of law, not courts of equity.").

Finally, it would appear that the issue of non-forfeiture provisions in employment contract or retainer agreements may grow in prominence as professionals may try to use such provisions to shield not only their retirement benefits but also their regular compensation. ERISA issues require specialized expertise beyond that of the author but non-forfeitability extends beyond ERISA regulations. Basic retirement plans are required to vest and therefore are required to be non-forfeitable. However 'Top Hat' plans are not required to be non-forfeitable but the dicta of at least two opinions indicates that a non-forfeiture clause would have saved those plans as well.³⁶⁵

V Other Claims and Remedies

A. Richard Scrushy: 'The CEO of the Fraud'³⁶⁶

Richard Scrushy was the founder of HealthSouth Corporation, a publicly held company that provided outpatient surgery and rehabilitative healthcare services. To enhance the corporation's executive bonus pool, fifteen or more Health South executives conspired to defraud the public with fabricated accounting statements between 1996 and 2002.³⁶⁷ As originally reported, each year was profitable in a cumulative amount of \$ 1.260 billion over the seven years. As eventually corrected and restated the company's net income was negative in each of those years (except 1996) in a cumulative loss of \$ 1.872 billion due to fraudulent entries, accounting changes and necessary write-downs in asset values.³⁶⁸

In 1999, before it was a prohibited practice, Scrushy borrowed \$ 25,218,114 from HealthSouth to buy 4,367,397 shares of Health South common stock at the price of \$5.78 per share. In 2002, he proposed to repay the loan ahead of time by tendering 2,506,770 shares of his stock which he represented was worth \$ 10.06, the market price of the stock on July 31, 2002. His buyback transaction was executed on August 1, 2002.³⁶⁹ Thereafter, the following facts came to light:

In August of 2002, HealthSouth issued a press release announcing that Scrushy had resigned as CEO (but remained as Chairman of the Board) and that the company needed to reduce its projections for the year's pre-tax earnings by \$175 million.³⁷⁰

³⁶⁵ See notes 102 and 103 and accompanying text.

³⁶⁶ Davidson, Laurence Viele; David, Beasley "HealthSouth's Scrushy Liable in \$2.88 Billion Fraud" Bloomberg, June 18, 2009

³⁶⁷ In re HealthSouth Corp. S'holders Litig., 845 A.2d 1096, 1102, 2003 Del. Ch. LEXIS 128 (Del. Ch. 2003)

³⁶⁸ Scrushy v. Tucker, 955 So. 2d 988, 1005, 2006 Ala. LEXIS 230 (Ala. 2006)

³⁶⁹ In re HealthSouth Corp S'holders Litig., 845 A. 2d at 1100

³⁷⁰ Id.

On March 3, 2003, HealthSouth announced it needed to make a 'write-down' of asset values of \$ 445 million for the fourth quarter of 2002 and 'other unusual charges' of \$194.8 million. By this time, the stock had fallen to \$.11 from \$ 10.08 on July 31, 2002.³⁷¹

On March 19, 2003, the Securities and Exchange Commission filed a complaint against HealthSouth, alleging violations of the securities laws.

At about the same time, the United States Attorney for the Northern District of Alabama separately announced that Weston Smith, the HealthSouth chief financial officer, had pled guilty to conspiring to falsify the financial statements from 1997 through 2003.³⁷²

On March 24, 2003, HealthSouth announced that it retained an outside accounting firm to conduct a forensic audit of the company's financial statements.

On March 25, 2003 the New York Stock Exchange announced the delisting of HealthSouth.

On March 31, 2003, Scrusby was formally fired.³⁷³

On July 7, 2003, the outside auditor provided the company with the preliminary estimate that prior earnings had been overstated by at least \$ 2.5 billion.)³⁷⁴

This accounting scandal generated two separate series of lawsuits. Criminal charges were filed in April of 2003 against Scrusby and a group of HealthSouth executives.³⁷⁵ In that case, fifteen Health South executives eventually plead guilty to a scheme to generate misleading financial statements for the purpose of enhancing profit sharing compensation. On June 28, 2005, Scrusby was found not guilty.³⁷⁶ He was subsequently indicted on charges of bribery, extortion and money laundering and convicted in June of 2006. He was sentenced to 82 months of prison³⁷⁷ from which he was released on July 25, 2012 after serving 74 months.³⁷⁸

In 2003 a series of civil lawsuits was filed as derivative actions. The main action related to the allegation that Scrusby had participated in the accounting fraud and caused huge damages to

³⁷¹ Id. at 1101

³⁷² Id at. 1101

³⁷³ Id.

³⁷⁴ Id. at 1102

³⁷⁵ Id.

³⁷⁶ Farrell, Greg, "Scrusby acquitted of all 36 charges" USA Today, June 28, 2005

³⁷⁷ Sims, "Siegelman, Scrusby taken into custody", Birmingham News, June 28, 2007

³⁷⁸ Hutchens, Aaron, "Richard Scrusby released from federal custody" Associated Press, July 26, 2012

the operations of Health South and the investing public.³⁷⁹ Separate claims related indirectly to the main action were allowed to proceed on their own. The first such independent claim related to the buyback transaction which was heard in Delaware Chancery Court.³⁸⁰ Later affirmed by the Delaware Supreme Court,³⁸¹ the Chancery Court granted a partial summary judgment motion against Scrusy which rescinded the buyback transaction.³⁸² The key point in that suit was that Scrusy was found liable on the claim of innocent misrepresentation which was Scrusy's statement that the market value on the date of the buyback was a fair representation of its value.³⁸³ Claims of fraud were not alleged but as CEO he was held responsible for the fact that grossly misrepresentative accounting statements were filed between 1996 and 2002 while he was CEO and that he greatly benefitted from those false accounting statements in the buyback transaction.³⁸⁴

In 2006 (after Scrusy was acquitted in the first criminal proceedings but also after the Health South executives pled guilty to filing grossly misstated accounting statements), a second motion for partial summary judgment was heard in an Alabama state court against Scrusy that claimed he had been unjustly enriched by being paid \$46.7 million of bonus payments between 1996 and 2002 for profits that did not in fact exist.³⁸⁵ The trial court granted the partial summary judgment motion for the years 1997 through 2002 in the amount of \$47.8 million (including prejudgment interest).³⁸⁶ The Alabama Supreme Court affirmed the order,

³⁷⁹ Scrusy v. Tucker, 70 So. 3d 289, 294, 2011 Ala. LEXIS 18 (Ala. 2011) ("In that connection, on August 8, 2003, Tucker filed a third amended complaint and a fourth amended complaint, asserting claims alleging, among other things, (1) improper "interested transactions," waste and "misappropriation of corporate assets"; (2) unjust enrichment; (3) breach of contract;(4) conspiracy; (5) "intentional, reckless, and innocent misrepresentation and suppression"; (6) breach of fiduciary duty of loyalty, related to fraud, false accounting, and "insider trading"; and (7) seeking to impose a constructive trust.")

³⁸⁰ In re HealthSouth Corp. S'holders Litig., 845 A.2d 1096, 1102, 2003 Del. Ch. LEXIS 128 (Del. Ch. 2003)

³⁸¹ In re HealthSouth Corp. S'holders Litig. v. Biondi, 847 A.2d 1121, 2004 Del. LEXIS 175 (Del. 2004)

³⁸² In re HealthSouth Corp. S'holders Litig., 845 A.2d at 1110

³⁸³ Id. at 1106 ("First, Scrusy represented to HealthSouth that the market price was a reliable way to value his shares, thereby vouching again for the integrity of the financial statements he had signed (and earnings projections he had caused the company to make).")

³⁸⁴ Id. at 1107 ("The CEO of a major corporation like HealthSouth possesses an enormous amount of authority and therefore owes the corporation a corresponding degree of responsibility. HealthSouth's board of directors was entitled to rely upon Scrusy and his management team, particularly in the preparation of the company's financial statements, an area in which management has traditionally been preeminent. In the process of preparing and signing financial statements, Scrusy necessarily represented to the company's board, audit committee, outside auditors, and its public stockholders that the financial statements his management team had prepared were materially accurate in all respects. As the auditor's report for HealthSouth's FY 2001 10-K stated: "These financial statements and schedule are the responsibility of the Company's management.")

³⁸⁵ Scrusy v. Tucker, 955 So. 2d 988, 1002, 2006 Ala. LEXIS 230 (Ala. 2006)

³⁸⁶ Id. at 1005

emphasizing that the cause of action for unjust enrichment in Alabama and Delaware does not require or presuppose that the defendant did anything wrong or dishonest.³⁸⁷

After the two partial summary judgments had been granted and affirmed by their respective state supreme court and after Scrusby was first acquitted and then later convicted of various felonies, the main civil case proceeded which alleged that Scrusby was involved in the accounting fraud and which led the trial judge to eventually state that Scrusby was "the CEO of the fraud."³⁸⁸

It is ironic that the largest judgment for compensation forfeiture (\$ 27 million) was also the least significant to the overall judgment, i.e. less than 1% of the total judgment. While Scrusby did appeal the judgment for compensation forfeiture, his assertions were strangely based on his claim that compensation forfeiture would only be warranted upon an order to rescind his employment agreements.³⁸⁹ The Alabama Supreme Court pointed out that the plaintiffs had pled a claim for breach of fiduciary duty for which they sought the remedy of compensation forfeiture.

As a case relating to compensation forfeiture, the Scrusby opinion seems weak due to the unusually weak defense.³⁹⁰ The claims for innocent misrepresentation and unjust enrichment seem much more interesting and applicable in the future against other examples of innocent misrepresentation by senior executives or in cases which you cannot prove that the defendant caused an obvious benefit.

³⁸⁷ Id. at 1012 ("We conclude that, under the law of either Delaware or Alabama, Scrusby was unjustly enriched by the payment of the bonuses, which were the result of the vast accounting fraud perpetrated upon HealthSouth and its shareholders, and that equity and good conscience require restitution in the form of repayment of those bonuses. Even though for purposes of the judgment the parties stipulated that Scrusby did not participate in and is not responsible for any of the criminal activities that resulted in the falsification of the financial statements, the trial court noted in its judgment that Scrusby does not dispute that the financial information originally filed by HealthSouth was inaccurate and unreliable. As between Scrusby and HealthSouth, it would be unconscionable to allow Scrusby to retain millions of dollars awarded to him in the form of bonuses at the expense of the corporation he served as chief executive officer and its shareholders.

³⁸⁸ Davidson, Laurence Viele, David Beasley "HealthSouth's Scrusby Liable in \$2.88 Billion Fraud," Bloomberg, June 18, 2009

³⁸⁹ Id. at 305 ("The gravamen of Scrusby's argument is that the remedy of disgorgement derives solely from equitable rescission. However, it is evident that the trial court "also" ordered the repayment as "damages for [Scrusby's] breach of the duty of loyalty.")

³⁹⁰ Id. at 306. ("Rather than address the forfeiture in the context of any of these grounds, Scrusby relies exclusively on his equitable-rescission argument. Under the following principles, he has waived a challenge to this aspect of the judgment...")

B. Asset Forfeiture

In 2010, the Texas Supreme Court affirmed a new variation on compensation forfeiture that is intended for possible use when a fiduciary breaches her fiduciary duty to the principal in the course of an asset transaction. It held that "...where willful actions constituting breach of fiduciary duty also amount to fraudulent inducement, the contractual consideration received by the fiduciary is recoverable in equity regardless of whether actual damages are proven, subject to certain limiting principles set out below."³⁹¹ So if one partner proposes a transaction that is based in fraud and a willful breach of fiduciary duty, the remedy would be to reverse the transaction except the partner in breach loses the consideration that he conveyed in the exchange (in addition to possible compensating damages, lost profits and punitive damages.)

In the actual case, the two parties, Snodgrass and Swinnea, were equal shareholders in an environmental consulting business, ERI Consulting Engineers, Inc. ("ERI"), and in a holding company that owned the headquarters property, Malmeba Company, Ltd. ("Malmeba"). In 2001, Swinnea sold his interest in ERI to Snodgrass and agreed not to compete with ERI for six years in exchange for \$ 497,500 and Snodgrass's interest in Malmeba. Evidence was presented at the bench trial that showed that Swinnea prepared to compete with ERI even before the transaction agreement was executed and even though Swinnea continued to work full time for ERI. It was shown that Swinnea expected to be able to buy ERI later for a depressed price after competition from his new company had "run [ERI] into the ground."³⁹²

The trial court awarded ERI and Snodgrass lost profits of \$ 300,000; asset forfeitures of \$437,500 (a portion of the \$ 497,500 paid to acquire Swinnea's interest in ERI); \$ 150,000 ("the value of Snodgrass's one-half interest in Malmeba transferred to Swinnea"); \$ 133,200 ("the sum of the lease payments from ERI to Malmeba after the buyout"); and \$ 1 million in exemplary damages.³⁹³ The twelfth district reversed the trial court, holding that Snodgrass take nothing as the lost profits were not sufficiently proven and the precedents for fee forfeiture do not justify the authority to forfeit assets. The supreme court reversed the court of appeals and affirmed the award (except for an adjustment to the amount of lost profits):

We later reiterated that a fiduciary may be punished for breaching his duty: "The main purpose of forfeiture is not to compensate an injured principal Rather

³⁹¹ ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 873 (Tex. 2010)

³⁹² Id. at 871.

³⁹³ Id. at 871-72.

the central purpose . . . is to protect relationships of trust by discouraging agents' disloyalty."³⁹⁴

Asset forfeiture, however, flouts most of the safeguards that prevent remedies in equity from exacting punitive measures. For example, asset forfeiture rejects counter-restitution, and therefore the remedy can easily exceed the defendant's gain, thereby breaching the protection implied in *Snepp*.³⁹⁵ The fiduciary that makes a substantial cash outlay to purchase or improve an asset that is subsequently forfeited is penalized in an amount that can be greater than any profit or benefit.³⁹⁶

Just as the state supreme court's opinion in *Burrow v. Arce*³⁹⁷ spurred more claims for fee forfeiture against lawyers, its subsequent opinion in *Swinnea* increased the number of claims for compensation forfeiture in the Texas courts. Given the shaky foundation for *Swinnea*'s extension of fee or compensation forfeiture to asset forfeiture, however, some of the new Texas appellate opinions appear to be outliers compared to the overall application of compensation forfeiture. One such outlying opinion was handed down in *Saden v. Smith*,³⁹⁸ which correctly held that the trial court could not award actual damages for both breach of contract and breach of fiduciary duty against an equal shareholder for disloyal competition because only one cause of action applied. However, in addition to awarding lost profits for breach of contract, the court also awarded disgorgement of the errant fiduciary's profits to deter breaches of fiduciary duty. (The compensation and personal expenses of the fiduciary and equal shareholder were not eligible for forfeiture because they had not been expensed by the plaintiff's expert in determining the plaintiff's lost profits.) The result was that the court of appeals held that the fiduciary was liable for \$941,907 in lost profits for breach of contract and an additional \$ 941,907 in disgorgement of the defendant's profits, rejecting the defendant's objections that the award was duplicative. The court clearly juxtaposed profit disgorgement for compensation forfeiture but the potential expansiveness of *Swinnea* surely encourages this mistake.

³⁹⁴ Id. at 873 quoting *Burrow v. Arce*, 997 S.W.2d 229, 238 (Tex. 1999)

³⁹⁵ See note 182 *infra*.

³⁹⁶ ANDREW BURROWS, *THE LAW OF RESTITUTION* 176 (2d ed. 2005) ("Though the defendant has been fraudulent, he must not be robbed, nor must the plaintiff be unjustly enriched, as he would be if he both got back what he had parted with and kept what he had received in return." (citations omitted)). See also *Clarke v. Dickson*, (1858) EB & E 148, 154, 120 ER 463, 465-66 (Crompton, J.)("If you are fraudulently induced to buy a cake you may return it and get back the price; but you cannot both eat your cake and return your cake.")

³⁹⁷ *Burrow v. Arce*, 997 S.W.2d 229, 244 (Tex. 1999).

³⁹⁸ 415 S.W.3d 450, 470 (Tex. App.—Houston [1st Dist.] 2013, pet. denied)

Other Texas cases apply compensation forfeiture in their own 'different way.' In a case against the former president of the company for disloyal compensation, the Fifth Circuit affirmed an award of \$ 342,116.80 for breach of contract which amounts to 100% of the fiduciary's compensation during the period of disloyalty and the plaintiff's lost profits for breach of fiduciary duty.³⁹⁹) In *Dernick Res., Inc. v. Wilstein*, the judge correctly added compensation forfeiture to lost profits.⁴⁰⁰ The interesting aspect in that case is that the trial judge awarded actual damages of \$ 162,000 and forfeiture of \$ 1.7MM (until the appeals court added another \$750,000 of actual damages). The court in *McCullough v. Scarbrough, Medlin & Assocs., Inc.*,⁴⁰¹ held that the plaintiff was entitled to choose between treatment as breach of contract or breach of fiduciary duty and specifically did not allow the breach of contract claim to add on forfeiture. Note however, the breach of fiduciary duty approach was allowed to claim actual damages, disgorgement and forfeiture.

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C.Fiduciary Claims Against Lawyers

³⁹⁹ *Advanced Nano Coatings, Inc. v. Hanafin*, 556 Fed. Appx. 316, 318 (5th Cir. Tex. 2014)

⁴⁰⁰ 2015 Tex. App. LEXIS 6684 (Tex. App. Houston 1st Dist. June 30, 2015). See also *White v. Pottorff*, 2015 Tex. App. LEXIS 8659, *21-22 (Tex. App. Dallas Aug. 18, 2015)(affirming the award of \$ 375,000 of compensation forfeiture.)

⁴⁰¹ 435 S.W.3d 871, 892 (Tex. App.—Dallas 2014, pet. denied)

Claims for breach of fiduciary duty against lawyers, one of the oldest applications of the claim,⁴⁰² will not be separately addressed in this article. There appears, however, to be a related issue that should be acknowledged. When former clients sue their lawyers for breach of fiduciary duty and legal malpractice, many states effectively recognize a form of pre-emption that acts to dismiss the fiduciary claim on summary judgment. In Texas between 1988 and 2012, defendant attorneys in 60% of cases with both claims were granted summary judgment for breach of fiduciary duty (77% of those dismissals were upheld on appeal.)⁴⁰³ (By comparison, in Texas between 1988 and 2012, defendant non-attorneys in 36% in cases with both claims were granted summary judgment for breach of fiduciary duty and 66% of those dismissals were affirmed.)⁴⁰⁴ The specific rationale in Texas is called 'fracturing.'⁴⁰⁵ There has been a surge in Texas and the rest of the country in claims against lawyers for legal malpractice and breach of fiduciary duty. The surge for legal malpractice has subsided but the surge in claims for breach of fiduciary duty continues. Courts in Texas perceived that many of the claims for breach of fiduciary duty were nothing more than the same claim for legal malpractice repeated into claims for breach of fiduciary duty and sometimes fraud. The fracturing defense has had such a marked impact on litigation against lawyers that the liability rate for lawyers is markedly lower than for non-lawyer defendants.⁴⁰⁶ Other states readily dismiss claims for breach of fiduciary duty against lawyers under the similar defense of duplicativeness.⁴⁰⁷

Case opinions that affirm summary judgement dismissals under fracturing or duplicativeness fail to explain how the defense complies with the notion of pleading in the alternative or why such defenses should not follow the standard in federal procedure for the defense of redundancy.⁴⁰⁸ More importantly, even if the doctrine of duplicativeness or fracturing were fully supported in legal doctrine, no court opinions have explained why the plaintiff should not be allowed to choose whether to have the malpractice or fiduciary duty claim dismissed nor

⁴⁰² See note 231 *infra*.

⁴⁰³ George P. Roach, *Texas Remedies in Equity for Breach of Fiduciary Duty: Disgorgement, Forfeiture, and Fracturing*, 45 *St. Mary's L. J.* 367, 387 (2014)

⁴⁰⁴ *Ibid*.

⁴⁰⁵ *Id.* at section VIII

⁴⁰⁶ George P. Roach, *Texas Remedies in Equity for Breach of fiduciary duty: Disgorgement, Forfeiture, and Fracturing*, 45 *St. Mary's L. J.* 367, 449 (2014)(concluding that out of fifty-two cases with claims for breach of fiduciary duty against a lawyer in which the fracturing defense was used, no defendants were found liable, five cases were remanded to the trial court, forty-five were affirmed for dismissing the claim and two reached the jury without liability to the lawyer.)

⁴⁰⁷ *E.g. Weil, Gotshal & Manges, LLP v. Fashion Boutique of Short Hills, Inc.*, 10 A.D.3d 267, 271 (N.Y. App. Div. 1st Dep't 2004)citing *Estate of Nevelson v Carro, Spanbock, Kaster & Cuiffo*, 290 A.D.2d 399, 400, 736 N.Y.S.2d 668 [2002] (" As to the claim for breach of fiduciary duty, we have consistently held that such a claim, premised on the same facts and seeking the identical relief sought in the legal malpractice cause of action, is redundant and should be dismissed.)

⁴⁰⁸ *Hardin v. American Elec. Power*, 188 F.R.D. 509, 511 (S.D. Ind. 1999) citing *Talbot v. Robert Matthews Distrib. Co.*, 961 F.2d 654, 664 (7th Cir. 1992) (" Mere redundancy or immateriality is not enough to trigger drastic measure of striking pleading or parts thereof; in addition, pleading must be prejudicial to defendant.")

how a claim for fiduciary duty can be duplicative of a claim for legal malpractice that is otherwise being simultaneously dismissed on other grounds.

However, the important point is that a cause of action for breach of fiduciary which seeks the remedy of compensation forfeiture or fee forfeiture is treated differently and not as readily dismissed as fiduciary claims that seek damages. Cases for breach of fiduciary duty have survived the defense of duplicativeness because the claimant is seeking a different remedy than the damages claim for legal malpractice.⁴⁰⁹ In Texas, despite the supreme court precedent that specifically reversed the dismissal of the plaintiff's causes of action for legal malpractice and breach of fiduciary duty for fee forfeiture, the trial courts and courts of appeals have found new grounds for dismissing such claims⁴¹⁰ but some claims have survived.⁴¹¹

Claims for fee forfeiture in Texas have been most successful in two class action cases. In *Burrow v. Arce*,⁴¹² the state supreme court reversed the appeals court and denied the lawyer-defendant's motion for summary judgment on the claims for malpractice and breach of fiduciary duty regarding a class action in which the lawyer gained contingency fees of \$ 60 million.⁴¹³ The case against the law firm of John O'Quinn P.C. went to arbitration and the panel in that case awarded forfeiture of \$ 25 million out of total fees of \$253.4 million.⁴¹⁴

⁴⁰⁹ *Ulico Cas. Co. v. Wilson, Elser, Moskowitz, Edelman & Dicker*, 16 Misc. 3d 1051, 1057 (2007)

⁴¹⁰ See sections VIII and IX of George P. Roach, *Texas Remedies in Equity for Breach of Fiduciary Duty: Disgorgement, Forfeiture, and Fracturing*, 45 St. Mary's L. J. 367 (2014)

⁴¹¹ See *Yaquinto v. Segerstrom (In re Segerstrom)*, 247 F.3d 218, 226 (5th Cir. 2001) ("While the Texas Supreme Court has dispensed with the need to prove an actual injury and causation when a plaintiff seeks to forfeit some portion of an attorney's fees in connection with a breach of fiduciary duty, see *Burrow v. Arce*, 997 S.W.2d 229, 240 (Tex. 1999), injury and causation are still required when a plaintiff seeks to recover damages for a breach of fiduciary duty."); *Balestri v. Hunton & Williams, LLP (In re Hallwood Energy, L.P.)*, 2014 U.S. Dist. LEXIS 130481, *3 (N.D. Tex. Sept. 17, 2014) ("Summary judgment/judgment on the pleadings is DENIED on count two (breach of fiduciary duty), but the plaintiff's remedy, in the event that liability is found, is limited to possible fee forfeiture."); and *Gammon v. Henry I. Hank Hodes & Diagnostic Experts of Austin, Inc.*, 2015 Tex. App. LEXIS 4235, p*25-26 (Tex. App. Austin Apr. 24, 2015)(affirming take nothing for lawyer's collection action, forfeiture of additional \$ 23,279.19 of paid lawyer's fees and denial of lawyer's claim for quantum meruit due to the breach of fiduciary duty owing to an unreasonable retainer agreement executed after representation had been initiated.)

⁴¹² 997 S.W.2d 229, 244 (Tex. 1999)

⁴¹³ *Id.* at 232.

⁴¹⁴ *John M O'Quinn P.C. v. Nat'l Union Fire Ins. Co.*, 33 F. Supp. 3d 756, 774 (S.D. Tex. 2014) (In the appellate opinion that affirmed the denial of malpractice coverage for the damages and forfeiture awarded against the law firm, the underlying claim for breach of fiduciary duty was detailed "Martha Wood, et al. v. John M. O'Quinn, P.C. et al, was filed in the 4th Judicial District Court, Rusk County, Texas on June 4, 1999 and ordered to arbitration in 2004." The arbitration panel's award was described as "On September 26, 2007, the Panel issued a final arbitration award (the "Final Award"). (Dkt. No. 345, Ex. 16).⁹ The Final Award held the O'Quinn Firm liable for damages totaling Forty-One Million Four Hundred Sixty-Five Thousand Nine Hundred Fifty and No/100 Dollars (\$41,465,950.00), in the following specific amounts: (1) Nine Million Nine Hundred Seventy-Nine Thousand Three Hundred Sixty-Four and No/100 Dollars (\$9,979,364.00), for breach of contract; (2) Two Million Four Hundred

VI Conclusions

Compensation forfeiture does not require testimony from an expert nor extensive motion practice on causation. If the former employee has been convicted of a related crime, liability for breach of fiduciary duty seems likely on a summary judgment basis. For the employer, pleading for compensation forfeiture is a low-risk, low-cost litigation tactic to increase the size of the remedy for a given set of claims and facts about the defendant's actions.

The dual goals for breach of fiduciary duty leads to multiple remedies for a single cause of action, including a remedy at law and a remedy in equity. When applicable, compensation forfeiture and punitive damages are stacked on top of the first two remedies without any offsets or adjustments. The result of a plea for compensation forfeiture is subject to the discretion of the trial judge who may react to the particularly egregious case facts or who may resist the remedy as excessive despite the evidence of serious disloyalty.

The underlying legal theory for compensation forfeiture also suffers from two major unproven assumptions. First, it seems unlikely that many employees are aware of their potential liability for disloyalty. Second, from a very limited sample of executives that got caught, it would appear that executives that are substantial violators of the duty of loyalty are also substantially irrational and not likely to be influenced by rational deterrence.⁴¹⁵

This article does not conclude or imply that compensation forfeiture is necessarily punitive or that remedy packages for breach of fiduciary duty that include compensation forfeiture are necessarily excessively punitive. However, remedies in equity like compensation forfeiture are now being regularly combined with remedies at law in a manner that contradicts the original constraints of both and that avoids the original safeguards against excessive relief.

Ninety-Four Thousand Eight Hundred Forty-One and No/100 Dollars (\$2,494,841.00), for attorneys' fees on the breach of contract claim; (3) Three Million Nine Hundred Ninety-One Thousand Seven Hundred Forty-Five and No/100 Dollars (\$3,991,745.00), in interest on the breach of contract damages; and (4) Twenty-Five Million and No/100 Dollars for fee forfeiture (\$25,000,000.00), and other related relief. (See Dkt. No. 345, Ex. 16). On October 12, 2007, the Rusk County court entered a final judgment confirming the Final Award in all respects. (Dkt. No. 345, Ex. 20). On December 4, 2009, the O'Quinn Firm, on its own, settled the Final Award for \$46.5 million. (Id., Ex. 21)."

⁴¹⁵ To be fair, however, deterrence itself would be very difficult to prove in either a positive or negative sense.

Appendix 1

Summary of Stacked Remedies For Breach of Fiduciary Duty

	Total Damages	Compensating Damages	Consequential Damages	Lost Value	Lost Profits	Disgorgement	Compensation Forfeiture	Punitive Damages	(H + I)/B	(H+I)/(C+D +E+F+G)
	B	C	D	E	F	G	H	I		
Dowd & Dowd, Ltd. v. Gleason, 352 Ill. App. 3d 365, 816 N.E.2d 754 (Ill. App. Ct. 2004)	2,464,889				1,652,029		812,860	400,000	49%	0.7
HTS, Inc. v. Boley, 954 F. Supp. 2d 927, 956 (D. Ariz. 2013)	179,473	36,991					88,937	53,545	79%	3.9
Levy v. Markal Sales Corp., 268 Ill. App. 3d 355, 382 (Ill. App. Ct. 1st Dist. 1994)	5,252,248	553,130					1,699,118	3,000,000	89%	8.5
Purolator Products, Inc. v. Forite Industries, Inc., 413 F.2d 989, 1969 U.S. App. LEXIS 11633, **3 (9th Cir. Cal. 1969)	31,236	12,982					10,754	7,500	58%	1.4
Vendo Co. v. Stoner, 58 Ill. 2d 289, 314 (1974)	7,345,000			5,039,165	2,135,000		170,835		2%	0.0
Vibra-Tech Eng'rs, Inc. v. Kavalek, 849 F. Supp. 2d 462, 467 (D.N.J. 2012)	3,390,054	16,962				2,045,094	197,980	1,130,018	39%	0.6
Enstar Group Inc. v. Grassgreen, 812 F. Supp. 1562, 1584 (N. D. Alabama 1993)	17,147,000	1,618,053	328,947				5,200,000	10,000,000	89%	9.4
Aramony v. United way of Am., 28 F. Supp. 2d 147, 185 (S.D.N.Y. 1998), rev'd in part on other grounds, 191 F.3d 140 (2d Cir. 1999)	2,321,944	357,889					1,914,055	50,000	85%	5.5
Astra USA, Inc. v. Bildman, 455 Mass. 116, 146, 914 N.E.2d 36, 2009 Mass. LEXIS 655 (2009)	7,819,812	1,040,812					6,779,000		87%	6.5

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Summary of Stacked Remedies For Breach of Fiduciary Duty

	Total Damages	Compensating Damages	Consequential Damages	Lost Value	Lost Profits	Disgorgement	Compensation Forfeiture	Punitive Damages	(H + I)/B	(H+I)/(C+D +E+F+G)	
	B	C	D	E	F	G	H	I			
TCD Pubis., Inc. v. Gittlitz, 24 N.E.3d 898, 911 (2014)	9,242,280	1,220,623					6,021,657	2,000,000	87%	6.6	
Average									66%	4.3	
Swinnea v. ERI Consulting Eng'rs, Inc., 364 S.W.3d 421, 424-25 (Tex. App. - Tyler 2012, pet. denied)	1,899,301	178,601					720,700	1,000,000	91%	9.6	
	Notes										
	a Figures shown do not include any credit for constructive trust or specific restitution										
	b Figure for compensation forfeiture includes \$ 300,000 for forfeiture of 'top hat' retirement plan.										
	c Figure for compensation forfeiture is actually asset forfeiture. See Section V B										