<u>ACCOUNTING FOR PROFITS</u>

Fiduciaries make a profit by virtue of their position as fiduciaries, without the fully-informed consent of their principal. Do they have to account for those profits to their principal? Yes. Does that answer change if the principal would have consented to the fiduciaries making (at least some of) those profits? No. These seemingly obvious answers were rightly given by all members of the Supreme Court in *Rukhadze v Recovery Partners GP Ltd* [2025] UKSC 10. The decision could have been very short indeed. Yet a panel of 7 judges produced 4 judgments over 113 pages, in which, *obiter*, a range of views were expressed about a number of issues which did not need to be decided. Unlike court judgments, this note is (sensibly) subject to a strict word limit. It can focus upon only some of the issues discussed.

The defendants owed fiduciary duties to the claimants, which provided asset recovery services. Whilst still in their positions as fiduciaries, the defendants obtained for themselves a business opportunity to provide services recovering assets for the family of a deceased Georgian billionaire. They subsequently resigned their positions with the claimants and exploited that opportunity. The trial judge held that the defendants had to account for all the profits which they had made from providing the recovery services, subject to an equitable allowance of 25%. The defendants appealed to the Supreme Court on the basis that the remedy of an account of profits should be limited by a "but-for" test of causation. That was rejected by the Supreme Court both in principle and on the facts, since the trial judge had determined that the profits would not have been made by the defendants had they not breached their fiduciary duties (see e.g. Lord Leggatt at [201]-[208]).

Lord Briggs (with whom Lord Reed, Lord Hodge and Lord Richards agreed) gave the majority judgment. He emphasised that "the former fiduciary is not allowed to defend his retention of the profit for himself by saying that he would have made it anyway, even if he had not committed a breach of fiduciary duty" (at [5]; see too Lord Leggatt at [177]-[181]; Lord Burrows at [270]). This encourages the fiduciary not to act in secret but rather to make full and frank disclosure to their principal, and actually to obtain the latter's consent. Given the power imbalance and, often, information asymmetry that exists between fiduciary and principal, this strict approach should not be watered down.

In *Bray v Ford* [1896] AC 44 at 50 Lord Herschell held that "a person in a fiduciary position … is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict". The relationship between the "no profit" and "no conflict" rules is difficult. Either the former is a sub-category of the latter, or the two rules are distinct. Which view is correct did not matter in *Rukhadze*: both rules were engaged. Their Lordships nevertheless discussed the topic, albeit without adding much clarity. Lord Briggs said that the two rules are "related" (at [16]) since they "both serve the same prophylactic purpose" (at [18]), and that the purpose of the no-profit rule is "to deter [fiduciaries] from undertaking that conflicting activity in the first place" (at [52]). However, he also insisted (at [20]) that the obligation to account for profits "is not just a discretionary equitable remedy for the breach of some other duty, such as the conflict rule, nor is it necessarily triggered by some other breach, although it very often is". A split in approach can be discerned in the other judgments: Lord Burrows appeared to think the no conflict rule should always be engaged (e.g. at [261], [264]), whereas Lord Leggatt forcefully argued that the no profit rule is independent (at [112]-[122]; although he thought the "profit rule" a "misnomer" (at [94]) and better expressed as a duty not to exploit property, information or opportunities). That does appear to be the better explanation for decisions such as *Boardman v Phipps* [1967] 2 AC 46, although rarely will it matter: when a fiduciary profits from their position as a fiduciary there is almost always a conflict of interest (as there was in *Rukhadze*).

It is, however, important to identify the profits which need to be disgorged (see generally Conaglen [2020] C.L.J. 38). Lord Briggs thought a "but-for" test of causation was unnecessary: all that is required is that the profits arose within the scope of the fiduciary relationship. That is consistent with the view that the "no-profit" rule does not require any breach of duty, and involves the enforcement of a primary obligation to account for profits made by virtue of being a fiduciary (e.g. Smith, *The Law of Loyalty* (OUP, 2023) ch.5). Lord Leggatt and Lord Burrows, by contrast, both firmly placed breach of fiduciary duty within the law of wrongs, such that a causal link to any profits is required. But whereas Lord Leggatt favoured a "but-for" test of causation, Lord Burrows considered that it was inappropriate to consider the counterfactual of the profits which the defendant might otherwise have lawfully obtained (at [270]). Causation is a notoriously tricky topic and "but-for" causation is not the only causal link available. *Rukhadze* supports the view that where fiduciaries make profits by virtue of their position they should give them up, even if they would otherwise have made those profits anyway, and that this approach should apply whether the remedy is characterised as enforcing a primary or secondary duty (at [48]). Again, though, none of this mattered on the facts of *Rukhadze*: even on a "but-for" test, the defendants had to account for their profits.

Many other issues, *obiter*, were canvassed by their Lordships, including whether an account of profits is not "just a remedy" (e.g. Lord Briggs at [20]-[22], [47]; compare Lord Leggatt at [209]-[230]); whether compensation and an account of profits are like "chalk and cheese" (as asserted by Lord Briggs (at [60]) but challenged by Lord Leggatt (at [170]; [196]-[200]); see too Lord Burrows at [277]-[279]); the meaning of "trust property" (at [102]-[106]); and to what extent and why the obligations of a fiduciary persist after the fiduciary resigns their position as fiduciary (see especially Lord Leggatt at [123]-[136]). There is much to be digested in the judgments.

Unfortunately, one issue which was not dealt with in detail in the Supreme Court, but was important on the facts of *Rukhadze*, was the equitable allowance. The Court of Appeal had emphasised that a wide discretion is afforded to trial judges, and that since the figure awarded at first instance was within the judge's discretion it would not be disturbed. But this is a difficult area. As Lord Briggs recognised, the equitable allowance is "discretionary and uncertain" (at [47]), which Lord Burrows thought "unsatisfactory" (at [294]). It does not fit easily with the idea that the obligation to account for profits made from a fiduciary position is a primary rather than secondary obligation (as pointed out by Lord Leggatt at [218]; see too Smith, *Loyalty* pp.219-220). Lord Burrows suggested that "making the allowance goes to the correct calculation of the net profit made by the defendant" (at [295]), which perhaps re-introduces a "but for" causal element at this stage. However, Lord Burrows also thought that there should not ordinarily be an equitable allowance "for a deliberate or cynical breach of fiduciary duty" (at [295]), even if that rested upon punitive reasoning. The basis and rationale of the equitable allowance remains opaque. Lord Briggs said that it "is a discretionary way of alleviating the potential injustice of transferring to a beneficiary the whole of the fruit of a fiduciary's hard work and skill" (at [55]) and can "temper the wind to the shorn lamb" (at [57]), but this gives very little guidance for future cases. Lord Briggs appeared to think such uncertainty desirable since this enhances the "deterrent effect of the profit rule" (at [58]). But that is unconvincing (cf. Lord Leggatt at [199]). It would have been helpful to understand how the Supreme Court would have approached the equitable allowance in *Rukhadze,* and indeed whether the Justices would have granted an allowance at all. Unsurprisingly, the appellants did not challenge the generous award of the trial judge. Unfortunately, the respondents were refused permission to appeal on this issue.

Given how straightforward and obvious the result in *Rukhadze* was, it may seem odd that the Supreme Court sat as an enlarged panel of 7 Justices. That was because the appellants asked that *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n and *Boardman* be overruled (or at least reinterpreted). But *Rukhadze* was never apt to prompt such a bold step. A more sympathetic case which might invite a review of those authorities would be one where the fiduciaries acted honestly and in the best interests of their principals; generated profits for their principals which would not otherwise have been made; and only by the fiduciaries' investing their own monies could any profits be made (at [139]). None of those elements were present in *Rukhadze* (at 142]). Yet even if they were, it seems highly unlikely that *Regal* or *Boardman* would be overruled. Lady Rose highlighted that legislation had been passed on the basis that *Regal* and *Boardman* were correct, such that any fundamental change in approach should be for the legislature. Whether that is really necessary or not, the clear signal from the Supreme Court is that *Regal* and *Boardman* remain correctly decided.