2006 s 175. In this case, the company provided services to customers using infrared technology, in particular for surveying commercial buildings to reveal hotspots caused by electrical faults. A former director launched his own business to offer thermal imaging surveys and was successful in canvassing orders from the claimant company's former clients. It was held that these possible new surveys more than eight months later cannot 'properly be described as a business opportunity in the course of maturing' [19] as at the director's resignation. Although it is not necessary to demonstrate that formal negotiations were underway; the learned judge found it hard to see how a claim can succeed without it being demonstrated that there had been at least some form of significant discussion of the potential business at the time of resignation.

➢ Questions

1. Can the decision in the *Peso Silver Mines* case be reconciled with *Boardman v Phipps* (earlier), *Aberdeen Rly Co v Blaikie Bros* **[7.34]** and the passage from *Keech v Sandford* quoted in *Regal (Hastings) Ltd v Gulliver* **[7.23]** ?

2. Is *Peso Silver Mines* likely to be embraced in the UK, even with the introduction of s 175(4)(a)?

Conflicts of duty and duty: competing directorships

Section 175(7) makes it clear that conflicts of duty and duty (ie conflicting duties of loyalty owed to two different principals) are within the remit of s 175.

The controversial House of Lords authority in this area is *Bell v Lever Bros Ltd* [1932] AC 161. It treats directors more leniently than employees are treated by employment law; it holds **(p. 405)** that directors are not under an obligation to refrain from competing with their companies or from becoming directors of rival companies, although this conclusion assumes that the first company has no concern in the contracts of the second, and that in earning the profit on those contracts the director has not made use of either the property or the confidential information belonging to the first company (see the opinion of Lord Blanesburgh).

The next case is unusual, but airs some of the concerns in this area. The extract is long, but this is a rare Court of Appeal authority on a difficult issue.

[7.33] In Plus Group Ltd v Pyke [2002] EWCA Civ 370, [2003] BCC 332 (Court of Appeal)

The company, In Plus Group Ltd, was controlled by two men, Pyke and Plank, its only directors and members. When the business relationship between Pyke and Plank deteriorated, Pyke was entirely excluded from the management of the company. He was refused access to financial records, no longer received his monthly payments from the company and his office was relocated without consultation or notice. With neither job nor income, Pyke established a new company and started doing business with Constructive, one of the company's major clients. The claimants argued that this competition with the company amounted to a breach of Pyke's fiduciary duties to it, and they sought an account of Pyke's profits.

> BROOKE LJ: … There is no completely rigid rule that a director may not be involved in the business of a company which is in competition with another company of which he was a director. A rather startling illustration of this proposition can be seen in the case of *London and Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165. Lord Mayo was a director and chairman of the board of directors of the first company which was incorporated for the purpose which its name suggests. He never in fact acted as a director, or attended a board meeting, or agreed, either expressly or in the articles of association, not to become a director of any similar company. Four months later the second company was formed for the same purpose. The first company had had some success with a share prospectus advertising Lord Mayo's name as director and chairman, and it took umbrage when it saw its rival's

prospectus with Lord Mayo's name at the head of its list of directors.

After summarising the facts, and adding that there was no contract, express or implied, obliging Lord Mayo to give his personal services to the plaintiff company and not to another company, Chitty J dismissed the plaintiffs' application for an injunction. He said that no case had been made out that Lord Mayo was about to disclose to the defendants any information that he had obtained confidentially in his character of chairman, and that an analogy sought to be drawn between the present case and partnership was incomplete.

This decision was applied with approval by Lord Blanesburgh in *Bell v Lever Bros Ltd* [earlier], at pp 193–196. He distinguished between contracts in which the director's own company was concerned and contracts by which the director was bound to some outside party. In relation to the latter class of contract he said that the company had no concern in the director's profit, and could not make him accountable for it unless it appeared—and this was the essential qualification—that in earning that profit he had made use either of the company's property or of some confidential information which had come to him as director of the company.

I have read in draft the judgment of Sedley LJ, and I need not repeat his description of the unease with which some modern text book writers have viewed the*Mashonaland* case. It is unnecessary on the present occasion to resolve this controversy, because the facts of the present case are so unusual. …

In the present case Mr Pyke, who was a sick man following his stroke, had been effectively expelled from the companies of which he was a director more than six months before any of the events occurred of which the claimants now make complaint. Although he had invested a very large **(p. 406)** sum of money in the first and second claimants on interest free loan accounts, he was not being permitted to withdraw any of it. At the same time he was being denied any remuneration from the companies. When he entered into business with Constructive in the autumn of 1997 he was not using any of the claimants' property for the purpose of that business. Nor was he making use of any confidential information which had come to him as a director of any of the companies.

In these circumstances I consider that the judge was right when he held that Mr Pyke committed no breach of fiduciary duty in trading with Constructive …

SEDLEY LJ: *London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd*, in its solitary briefly reported form [1891] WN 165, establishes that there is nothing inherently objectionable in the position of a company director (and chairman) who, without breaching any express restrictive agreement or disclosing any confidential information, becomes engaged, whether personally or as a director of another company, in the same line of business. The extempore judgment of Chitty J on what appears to have been an interlocutory motion for injunctive relief, was given the imprimatur of the House of Lords by Lord Blanesburgh in *Bell v Lever Bros* [earlier], at p 195. The case had not, according to the report, been referred to by counsel on either side in argument; but Lord Blanesburgh, with whom Lord Atkin and Lord Thankerton agreed, explicitly endorsed the principle set out by Chitty J. This, therefore, is the law which binds us. That it can produce outcomes of debatable morality is evident from the speeches in *Bell v Lever Bros* itself. Lord Blanesburgh remarked in conclusion (at p 200):

> 'Nor is it to my mind unjust that, their profit accounted for, the appellants should be left in possession by way of return for their services of sums which, while they may seem bountiful to minds disciplined in a school of progressive austerity, would doubtless, by those engaged in great business, he regarded as no more than adequate to the occasion.'

Lord Atkin on the other hand, though concurring in the result, said (at p 229):

> 'The result is that in the present case servants unfaithful in some of their work retain large

> compensation which some will think they do not deserve. Nevertheless it is of greater importance that well established principles of contract should be maintained than that a particular hardship should be redressed …'

The problem is obvious if one thinks of how shareholders in X Ltd or X plc, or for that matter its creditors, would regard a director who used his boardroom vote, perhaps crucially, in a way which helped a competitor, when the competitor was the director himself or another company of which he was also a director. Whatever the perceived commercial morality of such a situation, I do not consider that it is sanctioned by law. The fiduciary duty of a director to his company is uniform and universal. What vary infinitely are the elements of fact and degree which determine whether the duty has been breached. If Mr Pyke's solicitors' view of the law is as widely held as it seems to be, it needs to be revised. They wrote this:

> 'The authorities are quite clear that it is no breach of any fiduciary duty to be involved with a business either of the same kind or in competition with the company of which he is a director.'

Counsel have put before us what three of the leading modern textbooks say about this received view of the law. The authors' and editors' views range from the dubious to the sceptical. [He then cited from *Gore-Browne on Companies* (Jordans), para 27.17; *Palmer's Company Law* (Sweet & Maxwell), para 8.534, and continued:]

Gower's Principles of Modern Company Law (Davies, Sweet & Maxwell), 6th ed., says at p 622:

> '**Competing with the company**. One of the most obvious examples of a situation which might be expected to give rise to a conflict between a director's interests and his duties is where he carries on or is associated with a business competing with that of the company. Certainly a fiduciary without the consent of his beneficiaries is normally strictly precluded **(p. 407)** from competing with them and this is specifically stated in the analogous field of partnership law. Yet, strangely, it is by no means clear on the existing case law that a similar rule applies to directors of a company. Indeed, it is generally stated that it does not, and there appears to be a definite, if inadequately reported, decision that a director cannot be restrained from acting as a director of a rival company. And it has been said that "What he could do for a rival company he could, of course, do for himself." This view is becoming increasingly difficult to support. It has been held that the duty of fidelity flowing from the relationship of master and servant may preclude the servant from engaging, even in his spare time, in work for a competitor, notwithstanding that the servant's duty of fidelity imposes lesser obligations than the full duty of good faith owed by a director or other fiduciary agent. How, then, can it be that a director can compete whereas a subordinate employee cannot? Moreover it has been recognised that one who is a director of two rival concerns is walking a tight-rope and at risk if he fails to deal fairly with both.
>
> In arguing that a director who carries on a business which competes with that of his company inevitably places himself in a position where his personal interest will conflict with his duty to the company, it is not being contended that he will necessarily have breached his fiduciary duty; he will not if the company has consented so long as he observes his subjective duty to the company by subordinating his interests to those of the company. Nor is it being suggested that there is anything objectionable in his holding other directorships so long as all the companies have consented if their businesses compete. But in both cases consent is unlikely if he is a full-time executive director or if the extent of the competition is substantial. And even if the consent is given the director is likely to be faced with constant difficulties in avoiding breaches of his subjective duty of good faith to the company or companies concerned. He may be able to subordinate his personal interests to those of a single company but it is less easy to reconcile conflicting duties to more than one company. Nor

> would a reformed rule be inconsistent with the modern emphasis on a more important role for non-executive directors, who are often executive directors of other companies. Even if executive directors are regarded as a good source of non-executive talent for other companies (which some would question), a reformed rule would simply require executive directors not to become non-executive or competing companies, which they are, in fact, rarely asked to become.'

If one bears in mind the high standard of probity which equity demands of fiduciaries, and the reliance which shareholders and creditors are entitled to place upon it, the *Mashonaland* principle is a very limited one. If, for example, the two Mashonaland Exploration companies had been preparing to tender for the same contract, I doubt whether Lord Mayo's position would have been tenable, at least in the absence of special arrangements to insulate either company from the conflict of his interests and duties, for I see no reason why the law should assume that any directorship is merely cosmetic. A directorship brings with it not only voting rights and emoluments but responsibilities of stewardship and honesty, and those who cannot discharge them should not become or remain directors.

All the foregoing concerns breach of fiduciary duty. From such a breach, appropriate remedies will follow. But both common sense and equity indicate that it is not necessary to wait for a breach giving rise to a remedy before the possibility of intervention arises …

That the law will take notice of a situation of impending or potential breach, as well as of an actual one, is clear … [he cited various decisions, and continued:] Without the need of any proven breach, the court will set aside a transaction entered into in the shadow of such a conflict. It will also in an appropriate case restrain entry into such a transaction or restrain the director from involving himself in it. The distinction … between a director's putting himself into a position of conflict and his being in breach of fiduciary duty is of course legally correct and is relevant to remedies; but it does not mean that a director can cheerfully go to the brink so long as he does not fall over the edge. It means that if he finds himself in a position of conflict he must resolve it openly or extract himself from it …

In this situation the room in the present case for absolving Mr Pyke was very limited indeed. …

(p. 408) … Quite exceptionally, the defendant's duty to the claimants had been reduced to vanishing point by the acts (explicable and even justifiable though they may have been) of his sole fellow director and fellow shareholder Mr Plank. Accepting as I do that the claimants' relationship with Constructive was consistent with successful poaching on Mr Pyke's part, the critical fact is that it was done in a situation in which the dual role which is the necessary predicate of Mr Yell's case is absent. The defendant's role as a director of the claimants was throughout the relevant period entirely nominal, not in the sense in which a non-executive director's position might (probably wrongly) be called nominal but in the concrete sense that he was entirely excluded from all decision-making and all participation in the claimant company's affairs. For all the influence he had, he might as well have resigned.

For the rest, I agree with the judgments of my Lords …

JONATHAN PARKER LJ: I agree with the order proposed by Brooke LJ, for the reasons which he has given.

I further agree with him that this is not an appropriate case in which to examine the scope and application of what Sedley LJ refers to as the *Mashonaland* principle …

➢ Question

By bundling up conflicts of interest and duty and conflicts of duty and duty in the same provision (s 175), is CA 2006 likely to encourage a hardening of the courts' approach to the latter types of conflicts?

Duty not to accept benefits from third parties: CA 2006 s 176

For directors, this provision reformulates and replaces the equitable principle that fiduciaries must not accept bribes or secret commissions (*Attorney General for Hong Kong v Reid* [1994] 1 AC 324, PC).

Several points are worth noting:

(i) The statutory duty does not embrace the entire ambit of the broader equitable 'no profit' rule, which is subsumed in s 175. On the other hand, this duty is clearly related to the no conflict duty in s 175, since this duty, too, is not infringed if acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest (s 176(4)).
(ii) 'Benefits' are not defined in CA 2006. During parliamentary debates on the Bill, the Solicitor-General said: 'In using the word "benefit", we intend the ordinary dictionary meaning of the word. The *Oxford English Dictionary* defines it as "a favourable or helpful factor, circumstance, advantage or profit"' (HC Comm D, 11/7/06, cols 621–622). A benefit may be financial or non-financial, of any shape or size, although s 176(4) ensures that trivial benefits are not caught by the provision, and s 176(3) covers payment of normal salary and benefits.
(iii) The most significant difference between s 175 (no conflict) and this section (s 176, no benefits from third parties) is that there is no provision for authorisation by the board of directors. Of course, the company's articles could (although it is most unlikely) contain specific provisions concerning benefits from third parties (see s 180(4)(b) and s 232(4): provisions protecting directors from liability). Alternatively, s 180(4)(a) (consent, approval and authorisation by members) may apply, but see the following Questions. Finally, the members may ratify the receipt under s 239 (ratification of acts of directors): again, see the following Questions.

 ➢ Questions

1. What 'benefits' received by directors will be assessed under this section rather than under s 175? Section 175 catches a director's capture of corporate opportunities (benefits?) from third parties for personal benefit rather than for the company's benefit. Is the difference that the 'benefits' contemplated under s 175 could have been pursued *legitimately* by the company itself (and the section makes the likelihood of success in that pursuit irrelevant: s 175(2)), whereas the benefits contemplated under s 176 are benefits that the company could not (or not legitimately) have requested or accepted for itself, such as bribes and secret commissions? This approach would add much to these sections that is certainly not apparent from their terms. Indeed, the qualification in s 175(2), earlier, is worded sufficiently widely to cover situations where the company could not *legally* take the advantage, so discrimination in this way is not compelled by the terms of the section itself. Does the answer to this question matter?

2. Section 176 does not provide for board authorisation as a 'whitewashing' procedure. If the board *did* consent (in the manner fully set out in s 175(5)–(6)), could anyone obtain a remedy against the director for breach of duty?

3. The authorisation and ratification procedures for members (ss 180 and 239) expressly import any general law restrictions on granting pre-transaction approval or post-event ratification (see ss 180(4)(a) and 239(7)). Does the general law prevent members approving or ratifying a director's receipt of benefits from third parties? Are there any s 175 conflicts that could not be authorised or ratified?

4. If a director as employee of company A accepts bribes from company B, and company A is found guilty under the Bribery Act 2010 s 7, can company A then claim against the director under s 176? Accordingly, is it reasonable to argue that s 176 will now be more readily used because, with the Bribery Act regime in place, companies are more motivated to investigate and pursue against their directors (who are often employees of the companies) suspected of receiving bribes?

Duty to declare an interest in a proposed or existing transaction or arrangement: CA 2006 ss 177 and 182

Section 177 is the third of the general provisions designed to reformulate and codify the fiduciary duties owed by directors. It deals with conflicts of interest in *proposed*transactions or arrangements *with* the company. Directors with direct or indirect[63] interests in transactions proposed by the company must declare to the other directors the nature and extent of those interests, unless it is an interest, or involves a transaction, of which the director is unaware.

Section 180 then makes it clear that, *subject to the company's constitution*, if directors comply with s 177, the transaction is not liable to be set aside by virtue of the usual equitable rule requiring the consent of the company's members. This is the significant reform introduced by this provision.

Failure to comply with s 177 constitutes a breach of duty, for which the purely civil remedies in s 178 apply. If the company then enters into the impugned transaction, the director is under a new and continuing duty to disclose, expressed in substantially similar terms in s 182 (declaration of interest in existing transaction or arrangement). Breach of s 182 is an offence **(p. 410)** (s 183).[64] Why the two regimes need to be separated at all, or by three intervening provisions, is not clear. (On s 182, see 'Declarations of interest in existing transactions or arrangements: ss 182–187', pp 445ff.)

Under various subsections in s 177, directors are treated as being aware of matters of which they ought to be aware; declarations must be updated if necessary; the form of disclosure is not prescribed, but may be made at a meeting of directors, by notice in writing, or by general notice. The articles may impose further requirements. Certain exceptions exist; all are reflected in existing common law rules. These apply where there is no reasonable likelihood of a conflict (*Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045); where the other directors are already aware or ought reasonably to be aware of the interest; and where the interest concerns service contracts which have been, or are to be, considered by a meeting of directors or by a remuneration committee (*Runciman v Walter Runciman plc* [1992] BCLC 1084). A fourth exception, not included in the section but recognised in s 186, is that the director of a company with only one director is not required to make a declaration to himself, although the terms of these arrangements must be set out in writing or recorded in the minutes (s 231).

If a director enters into a transaction or arrangement with the company in breach of s 177 (ie without making the appropriate declaration to the directors), then the transaction is voidable.[65] For the ramifications of this, see the Note following the next extract. The more general issues relating to remedies are discussed at 'General issues', pp 413ff.

For the impact of possible authorisation or ratification by the members, see 'Ratification of acts of directors: CA 2006 s 239', pp 437ff.

Transactions between the company and its directors (or a company with which the directors are associated) are voidable at the option of the company unless approved by the company.

[7.34] Aberdeen Rly Co v Blaikie Bros (1854) 1 Macq 461 (House of Lords)

The respondents, Blaikie Bros, had agreed to manufacture iron chairs for the railway company at £8.50 per ton, and sued to enforce the contract. The railway company pleaded that it was not bound by the contract because, at the time when it was made, the chairman of its board of directors was also managing partner of the respondents. This plea was upheld by the House of Lords.

> LORD CRANWORTH LC: This, therefore, brings us to the general question, whether a director of a railway company is or is not precluded from dealing on behalf of the company with himself, or with a firm in which he is a partner.
>
> The directors are a body to whom is delegated the duty of managing the general affairs of the company.

A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal.[66] And it is a rule of universal **(p. 411)** application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.

So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.

It obviously is, or may be, impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the interest of the cestui que trust, which it was possible to obtain.

It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interest of those for whom he is a trustee, have been as good as could have been obtained from any other person—they may even at the time have been better.

But still so inflexible is the rule that no inquiry on that subject is permitted. The English authorities on this head are numerous and uniform.

The principle was acted on by Lord King in *Keech v Sandford*,[67] and by Lord Hardwicke in *Whelpdale v Cookson*,[68] and the whole subject was considered by Lord Eldon on a great variety of occasions …

It is true that the questions have generally arisen on agreements for purchases or leases of land, and not, as here, on a contract of a mercantile character. But this can make no difference in principle. The inability to contract depends not on the subject-matter of the agreement, but on the fiduciary character of the contracting party, and I cannot entertain a doubt of its being applicable to the case of a party who is acting as manager of a mercantile or trading business for the benefit of others, no less than to that of an agent or trustee employed in selling or letting land.

Was then Mr Blaikie so acting in the case now before us?—If he was, did he while so acting contract on behalf of those for whom he was acting with himself?

Both these questions must obviously be answered in the affirmative. Mr Blaikie was not only a director, but (if that was necessary) the chairman of the directors. In that character it was his bounden duty to make the best bargains he could for the benefit of the company.

While he filled that character, namely, on 6 February 1846, he entered into a contract on behalf of the company with his own firm, for the purchase of a large quantity of iron chairs at a certain stipulated price. His duty to the company imposed on him the obligation of obtaining these chairs at the lowest possible price.

His personal interest would lead him to an entirely opposite direction, would induce him to fix the price as high as possible. This is the very evil against which the rule in question is directed, and here I see nothing whatever to prevent its application.

I observe that Lord Fullerton seemed to doubt whether the rule would apply where the party whose act or contract is called in question is only one of a body of directors, not a sole trustee or manager.

But, with all deference, this appears to me to make no difference. It was Mr Blaikie's duty to give to his co-directors, and through them to the company, the full benefit of all the knowledge and skill which he could bring to bear on the subject. He was bound to assist them in getting the articles contracted for at the cheapest possible rate. As far as related to the advice he should give them, he put his interest in conflict with his duty, and whether he was the sole director or only one of many, can make no difference in principle.

The same observation applies to the fact that he was not the sole person contracting with the company; he was one of the firm of Blaikie Brothers, with whom the contract was made, and so interested in driving as

hard a bargain with the company as he could induce them to make …

LORD BROUGHAM delivered a concurring opinion.

(p. 412) ➢ Questions

1. Given the reasons for the strict rule set out in this case, is the approach adopted in CA 2006 s 177 warranted? Will the company get 'the full benefit of all the knowledge and skill which [the director] could bring to bear on the subject'?

2. The traditional equitable rule was that disclosure must be to the members; disclosure to a disinterested quorum of directors was insufficient (unless the articles provided otherwise, which they usually did). This is now amended by s 177. But was the equitable rule itself open to question? Directors owe their fiduciary duties to the company, so the *company* must consent to any potential conflicts. So do cases such as *John Shaw & Sons (Salford) Ltd v Shaw* **[4.07]** suggest that where there is a board of directors capable of acting, it and it alone is competent to make business decisions for the company?

➢ Note

In these cases where the director's breach involves a contract *with* the company, the contract is voidable at the option of the company. It follows that the company will lose its right to rescind, on general contractual principles, if it has affirmed the transaction, or cannot make proper restitution (*restitutio in integrum*), or the rights of a third party would be adversely affected.

On orthodox principles, rescission is the *only* remedy (unless the director has also infringed some other rule that will deliver an alternative), and if rescission is no longer possible for any of these reasons, then the court will not intervene. The cases dealing with promoters, for example *Erlanger v New Sombrero Phosphate Co* **[8.06]** and*Re Cape Breton Co* (Note 3 following *Gluckstein v Barnes* **[8.07]**, p 486), confirm this. Also see *Cook v Deeks* **[7.22]**. Even though impugned contracts between the director and the company are an illustration of the 'no conflict' duty, for which directors are typically required to disgorge the profits they have made (holding them on constructive trust for the company, see the Note following *JJ Harrison (Properties) Ltd v Harrison* **[7.36]**, p 421), the courts in these cases say that the director's profit is 'unquantifiable' since that would involve the courts fixing a new contract price for the parties. Given all the other situations in which courts are content to make commercial assessments of value, this seems precious.

And if the courts will not give a 'profits' remedy for breach of the fiduciary duty, few options remain. The company cannot sue the director for breach of the contract, because by definition the contract is either affirmed (not breached) or rescinded (so rendered totally ineffective from the outset). The only option is to avoid (rescind) the contract and seek a personal (monetary) restitutionary remedy; this practice seems to be becoming increasingly acceptable.[69]

Remedies for breach of general duties: CA 2006 s 178

The remedies for breach of directors' duties have not been codified, despite the recommendations of the Law Commissions. CA 2006 s 178 preserves the existing civil consequences of breach (or threatened breach) of any of the general duties. If the statutory duty departs from its equitable equivalent, the court will have to identify the equivalent rule and apply the same consequences and remedies. For the avoidance of doubt, s 179 makes the obvious point that more than one of the general duties may apply in any given case.

(p. 413) The consequences of breach may include:

(i) injunctions and declarations (generally only when the breach is still threatened);
(ii) common law damages or equitable compensation where the company has suffered loss;[70]
(iii) restoration of the company's property, following a declaration that the property is held by the director on constructive trust for the company;
(iv) an account of profits made by the director; or
(v) rescission of a contract where the director failed to disclose an interest.

Also see s 1157 (power of court to grant relief in certain circumstances) that replaces CA 1985 s 727.

General issues

Many of the cases in the preceding pages of this chapter include a discussion of the relevant remedial issues. See especially *Cook v Deeks* **[7.22]**; *Regal (Hastings) Ltd v Gulliver* **[7.23]**; *In Plus Group Ltd v Pyke* **[7.33]**; *CMS Dolphin Ltd v Simonet* **[7.31]**; *Ultraframe (UK) Ltd v Fielding* **[7.44]**, paras [1511]–[1576].

The next extract repays careful reading. It illustrates and helps to explain many of the more significant problems in this area.[71] Note, in particular, the irrelevance of the fact that the company could not have made the profit now being claimed from the director or that the company would have given consent if requested; note also the deterrence function, the objective to strip profits and the problems in identifying the relevant profits.

The account of profits remedy—issues of causation and quantification.

[7.35] Murad v Al-Saraj [2005] EWCA Civ 959 (Court of Appeal)

Westwood (W) was a company owned by Al-Saraj (S). S had proposed to the Murads (M), who were two sisters, that they should together buy a hotel for £4.1 million, S contributing £500,000 to the purchase price, M contributing £1 million and the balance being borrowed from a bank. M and W entered into an agreement regulating the distribution of the proceeds of sale pro rata according to their initial contributions (ie 1/3:2/3). The hotel was purchased by a company (D) owned by S and M. The hotel was subsequently sold for a profit of £2 million. In proceedings by M the judge held that there had been a fiduciary relationship between S and M in relation to the joint venture to buy the hotel and that S had fraudulently misrepresented that his contribution would be made in cash, when in fact it had been made by setting off obligations owed by the vendor to S. He ordered that S and W should account to M for the entire profit that they had made from the transaction. The appellants submitted that the account of profits should have been limited to the profits obtained by the breach of fiduciary duty on the basis that if the set-off arrangement *had* been disclosed to M they would have agreed to go ahead but with a higher profit share so that S and W should only be liable for the loss incurred by M as a result of the non-disclosure of the set-off arrangement. **(p. 414)**

ARDEN LJ:

46. … The judge gave a remedy of account because there was a fiduciary relationship. For wrongs in the context of such a relationship, an order for an account of profits is a conventional remedy. …

54. The argument which Mr Cogley [counsel for S] makes is a powerful one. His case is that, where a fiduciary is made to account, there has to be a link between the profit and his wrongful act. …

55. On Mr Cogley's submission, the account ordered by the judge would not be restitutionary or restorative. It would result in unjust enrichment of the Murads. It is (he submits) wrong in principle that the Murads should receive the benefit of any profits which, if there had been full disclosure, they would have been content for Mr Al-Saraj to have. They all along anticipated being co-venturers with him and so expected him to have a share of the profits from the acquisition of Parkside Hotel. Increases in profits not attributable to his wrongful conduct should be excluded from the profits for which he has to account. …

56. To test Mr Cogley's argument on the extent of the liability to account, in my judgment it is necessary to

go back to first principle. … Equity recognises that there are legal wrongs for which damages are not the appropriate remedy. … a court of equity instead awards an account of profits … the purpose of the account is to strip a defaulting fiduciary of his profit. …

59. I would highlight two well-established points about the reach of the equitable remedies: (1) the liability of a fiduciary to account does not depend on whether the person to whom the fiduciary duty was owed could himself have made the profit. (2) when awarding equitable compensation, the court does not apply the common law principles of causation.

60. Proposition (1) is established by numerous authorities. … [including *Regal (Hastings)* **[7.23]**: 'The liability arises from the mere fact of a profit having, in the stated circumstances, been made.']

61. The position is no different in Australia: see *Warman International Ltd v Dwyer* [72], where the High Court specifically rejected the notion of unjust enrichment:

> 'It has been suggested that the liability of the fiduciary to account for a profit made in breach of the fiduciary duty should be determined by reference to the concept of unjust enrichment, namely, whether the profit is made at the expense of the person to whom the fiduciary duty is owed, and to the honesty and bona fides of the fiduciary. But the authorities in Australia and England deny that the liability of a fiduciary to account depends upon detriment to the plaintiff or the dishonesty and lack of bona fides of the fiduciary.' (page 557)

62. The High Court went on to say that (in a context such as this) the fiduciary will be liable to account (only) 'for a profit or benefit if it was obtained by reason of his taking advantage of [an] opportunity or knowledge derived from his fiduciary position' (page 557). It must of course be the case that no fiduciary is liable for all the profits he ever made from any source. However, it is clear that the High Court contemplated that the relevant profits would be ascertained through the process of the account. The court held: 'Ordinarily a fiduciary will be ordered to render an account of the profits made within the scope and ambit of his duty.' (page 559)

63. The High Court considered the allowances appropriate in that case. It concluded that a distinction should be drawn between the profits made from the use of a specific asset and those generated by a business which the defaulting fiduciary had diverted to himself. In the latter case, an allowance for skill, experience and expenses might have to be made. I return to the question of allowances below.

64. The High Court made it clear that the power to make an allowance for skill and efforts (or some other reason):

> 'is not to say that the liability of a fiduciary to account should be governed by the doctrine of unjust enrichment, though that doctrine may well have a useful part to play; it is simply to say that the stringent rule requiring a fiduciary to account for profits can be carried to extremes **(p. 415)** and that in cases outside the realm of specific assets, the liability of the fiduciary should not be transformed into a vehicle for the unjust enrichment of the plaintiff.' (page 561) …

67. The fact that the fiduciary can show that that party would not have made a loss is, on the authority of the *Regal* case, an irrelevant consideration so far as an account of profits is concerned. Likewise, it follows in my judgment from the *Regal* case that it is no defence for a fiduciary to say that he would have made the profit even if there had been no breach of fiduciary duty.

68. … liability does not depend on fraud or lack of good faith. The existence of a fraudulent intent will, however, be relevant to the question of the allowances to be made on the taking of the account (which subject I consider below). …

70. The next issue is that of authorisation or consent to the breach of duty. There was no consent in fact in this case. What is said is that the Murads would have consented to the set off arrangement and reduction in the purchase price for the hotel, if they had been asked. The House of Lords in the *Regal* case recognised that there would have been no liability to account in that case if the directors had been authorised by their company to take the opportunity which they had appropriated for themselves. …

71. In my judgment it is not enough for the wrongdoer to show that, if he had not been fraudulent, he could have got the consent of the party to whom he owed the fiduciary duty to allow him to retain the profit. The point is that the profit here was in fact wholly unauthorised at the time it was made and has so remained. To obtain a valid consent, there would have to have been full and frank disclosure by Mr Al-Saraj to the Murads of all relevant matters. It is only actual consent which obviates the liability to account. …

77. … for the policy reasons, on the taking of an account, the court lays the burden on the defaulting fiduciary to show that the profit is not one for which he should account …

78. This principle was applied by the High Court of Australia in the *Warman* case:

> 'It is for the defendant to establish that it is inequitable to order an account of the entire profits. If the defendant does not establish that that would be so, then the defendant must bear the consequences of mingling the profits attributable to those earned by the defendant's efforts and investment, in the same way that a trustee of a mixed fund bears the onus of distinguishing what is his own.'

79. In the *Warman* case, the defaulting fiduciary was able to show that some of the profit was not attributable to his wrongful act, but to his own skill and effort. The Court limited the account accordingly. On the facts, the court was satisfied that the period of time for which profits were to be accounted should be limited to two years. I will come back to this point below.

80. The above examination of the rule of equity applied in the *Regal* case is not promising for Mr Cogley's argument. On the contrary, on its most obvious analysis, his argument is clearly inconsistent with it, since the essence of his approach is to seek to limit Mr Al-Saraj's liability to account for profit to the loss suffered by the Murads. As the *Regal* case shows, liability to account for profit in equity does not depend on whether the beneficiary actually suffered any loss. I thus turn to consider whether there is any other way in which Mr Cogley's argument can be analysed in conformity with the principles of equity. …

82. [After considering various mechanisms that equity uses to moderate the severity of its equitable remedies against defaulting fiduciaries, Arden LJ continued:] Moreover, it would not be impossible for a modern court to conclude as a matter of policy that, without losing the deterrent effect of the rule, the harshness of it should be tempered in some circumstances. In addition, in such cases, the courts can provide a significant measure of protection for the beneficiaries by imposing on the defaulting trustee the affirmative burden of showing that those circumstances prevailed. Certainly the Canadian courts have modified the effect of equity's inflexible rule (see *Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1; see also the decision of the Privy Council on appeal from Australia in *Queensland Mines v Hudson*(1978) 52 AJLR 399), though I express no view as to the circumstances in which there should be any relaxation of the rule in this jurisdiction. That sort of question must be left to another court.

(p. 416) 83. In short, it may be appropriate for a higher court one day to revisit the rule on secret profits and to make it less inflexible in appropriate circumstances, where the unqualified operation of the rule operates particularly harshly and where the result is not compatible with the desire of modern courts to ensure that remedies are proportionate to the justice of the case where this does not conflict with some other overriding policy objective of the rule in question.

84. … Mr Al-Saraj was found to have made a fraudulent misrepresentation to the Murads who had placed their trust in him. I do not consider that, even if we were free to revisit the *Regal* case, this would be an appropriate case in which to do so. The appropriate remedy is that he should disgorge all the profits, whether of a revenue or capital nature, that he made from inducing the Murads by his fraudulent