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

representations from entering into the Parkside Hotel venture, subject to any allowances permitted by the court on the taking of the account.

85. The imposition of liability to account for secret profits and the placing of the burden of proof on the defaulting trustee are not, however, quite the end of the matter. The kind of account ordered in this case is an account of profits, that is a procedure to ensure the restitution of profits which ought to have been made for the beneficiary and not a procedure for the forfeiture of profits to which the defaulting trustee was always entitled for his own account. That is Mr. Cogley's case and I agree with him on this point. Even when the fiduciary is not fraudulent, the profit obtained from the breach of trust has to be defined. … equity does not take the view that simply because a profit was made as part of the same transaction the fiduciary must account for it. … [See] *Docker v Somes* (1834) 39 ER 1095 at 1099, where Lord Brougham expressed the view that in some circumstances a trustee who had applied considerable skill and labour to trust property which he had misapplied would be awarded a share of the product of his skill and labour:

> 'Mr. Solicitor General might have taken the case of trust money laid out in purchasing a piece of steel or skein of silk, and these being worked up into goods of the finest fabric, Birmingham trinkets or Brussels lace, where the work exceeds by 10,000 times the material in value. But such instances, in truth, prove nothing; for they are cases not of profits upon stock, but of skilful labour very highly paid; and no reasonable person would ever dream of charging a trustee, whose skill thus bestowed had so enormously augmented the value of the capital, as if he had only obtained from it a profit; although the refinements of the civil law would certainly bear us out, even in charging all gains accruing upon those goods as in the nature of accretions belonging to the true owners of the chattels.'

86. … The profit which belongs to the trust has to be disentangled from that which belongs to the defaulting trustee because it is a profit of his business. I have explained above how these difficulties were resolved in the *Warman* case by limiting the account to two years' profits. The problem in the *Warman* case has also faced courts within our own jurisdiction. In *Vyse v Foster* (1872) 9 Ch App 309, one of the partners in a business died but his capital remained in the business and was thus used by the surviving partners. One of the residuary legatees of the deceased partner sought an account of the share of the profits of the business to which she was entitled. … This court was prepared in principle to ascertain the share of the profits of the business but when it came down to working out how this was to be done this court decided that the appropriate remedy would be to order repayment of the capital with interest. In his judgment, James LJ held that the share of profits to which the plaintiff was entitled could not simply be ascertained by working out the proportion of the capital to which she was entitled …

87. Does this line of authority help Mr Al-Saraj in this case? I think not. …

88. It would, however, be open to Mr Al-Saraj to apply to the court for an allowance for his services and disbursements, as indeed he did. …

JONATHAN PARKER LJ:

96. I agree that the appeal should be dismissed and the cross-appeal allowed, essentially for the reasons given by Arden LJ. However, since Clarke LJ … takes a different view from Arden LJ on question of the extent of Mr Al-Saraj's liability to account for the profits which he has made from the joint venture, I will give my reasons for agreeing with Arden LJ's conclusion on that issue in my own words. …

(p. 417) 98. On those findings [of fact] it is beyond argument that, unknown to the Murads (and hence without their consent), Mr Al-Saraj placed himself in a position of acute conflict between his fiduciary duty to them in relation to the joint venture and his personal interest in earning a secret commission from the vendor. … [Then followed a detailed analysis of the key authorities on the no conflict rule.]

108. It is thus clear on authority, in my judgment, that the 'no conflict' rule is neither compensatory nor restitutionary: rather, it is designed to strip the fiduciary of the unauthorised profits he has made whilst he is

in a position of conflict. As Lord Keith observed in *Attorney-General v. Guardian Newspapers Ltd (No 2)* [1990] 1 AC 109, at 262E–F, the remedy of an account of profits:

> 'is, in my opinion, more satisfactorily to be attributed to the principle that no one should be permitted to gain from his own wrongdoing'. …

110. By contrast, however, in addressing a claim for equitable compensation for breach of trust the court may have regard to what would have happened but for the breach [see Millett LJ in *Bristol & West Building Society v Mothew* [1998] Ch 1 at 17H; Lord Browne-Wilkinson in *Target Holdings Ltd v Redferns* [1996] 1 AC 421 at 436; and *Gwembe Valley Development Co Ltd v Koshy* [2003] EWCA 1048 at [147] per Mummery LJ.]

111. I therefore conclude, on the basis of long-standing authority, that Mr Al-Saraj's liability to account extends to the entirety of the profits which he made from the joint venture. As the judge put it (at the hearing on 12 July 2004):

> 'the general principle is that a fiduciary is obliged by the strict rule of equity to disgorge all the profits that he has made from the transaction, which has involved his breach of duty, … it does not matter whether or not the transaction would have been entered into by the beneficiary instead of the fiduciary in its entirety or as to part.'

112. The judge's reference to the transaction 'which has involved his breach of duty' is important, for the fiduciary is liable to account only for profits which he has made 'within the scope and ambit of the duty which conflicts or may conflict with his personal interest' [*Boardman v Phipps* at 127D per Lord Upjohn]. In the instant case, however, the point does not arise, since on the judge's findings all the profits which Mr Al-Saraj made from the joint venture fall within that description.

113. In *Warman International Ltd v. Dwyer* … the defendants, in breach of their fiduciary duty to the claimant company, set up a competing business. The trial judge awarded the company a sum as an account of profits, but refused to declare that the defendants held part of the new business on trust for the claimant. He also awarded the claimant damages equal to half the value of the goodwill of the business. The Queensland Court of Appeal allowed the defendants' appeal on the ground that the claimant company was entitled only to the loss flowing from the breach of fiduciary duty. On the claimant company's appeal, the High Court of Australia held the defendants liable to account to the claimant company for the profits made by the new business during its first two years of operation.

114. In the course of its judgment, after citing an observation by Upjohn J in *In re Jarvis decd* [1958] 1 WLR 815 at 821 that in dealing with a business 'the principles applying are quite different from those in the case of a specific asset, such as a renewed lease', and an earlier observation to the same effect by Knight Bruce LJ in*Clegg v. Edmondson* (1857) 8 De G. M. & G. 787 at 814, the High Court of Australia continued:

> 'In the case of a business it may well be inappropriate and inequitable to compel the errant fiduciary to account for the whole of the profit of his conduct of the business or his exploitation of the principal's goodwill over an indefinite period of time. In such a case, it may be appropriate to allow the fiduciary a proportion of the profits, depending on the particular circumstances. That may well be the case when it appears that a significant proportion of an increase in profits has been generated by the skill, efforts, property and resources of the fiduciary, the capital he has introduced and the risks he has taken, so long as they are not risks to which the principal's property has been exposed. Then it may be said that the relevant proportion of the increased **(p. 418)** profits is not the product or consequence of the plaintiff's property but the product of the fiduciary's skill, efforts, property and resources. That 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 and that in cases outside the realm of specific assets, the liability of a fiduciary should not be transformed into a vehicle for the unjust enrichment of the plaintiff.

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 the defendant's breach of fiduciary duty and 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.

Whether it is appropriate to allow an errant fiduciary a proportion of profits or to make an allowance in respect of skill, expertise and other expenses is a matter of judgment which will depend on the facts of the given case. However, as a general rule, in conformity with the principle that a fiduciary must not profit from a breach of fiduciary duty, a court will not apportion profits in the absence of an antecedent arrangement for profit-sharing but will make an allowance for skill, expertise and other expenses.'

115. I do not, for my part, read that passage in the judgment of the High Court of Australia as sanctioning any departure from, or as recognising any qualification to, the 'no conflict' rule. Rather, as I read its judgment, the court is regarding the defendants as trustees who have made a profit from trust property in breach of what I may call the 'no profit' rule, and recognising that given that the property in question is the goodwill of the claimant company's business, there will in all probability come a time when it can safely be said that any future profits of the new business will be attributable not to the goodwill misappropriated from the claimant company when the new business was set up but rather to the defendants' own efforts in carrying on that business.

116. Even if, contrary to my reading of its judgment, the court is applying the 'no conflict' rule as opposed to the 'no profit' rule, the conclusion which it reaches is in my judgment entirely consistent with the 'no conflict' rule in that it is merely recognising that an order for an account of all the profits of the new business over an indefinite period would in all probability include profits which are not tainted in any way by the position of conflict in which the defendants placed themselves: that is to say profits which … are not within the scope and ambit of the relevant fiduciary duty and hence not within the scope of the 'no conflict' rule. In *Warman* itself, the court concluded that the appropriate cut off point was the expiry of two years after the commencement of the new business.

117. If, contrary to my reading of the court's judgment in *Warman*, the court was (as Clarke LJ concludes that it was) recognising or introducing a qualification to the 'no conflict' rule, then I can only say that, on my reading of the authorities, no such qualification exists as yet in this jurisdiction. …

121. All that said, there can be little doubt that the inflexibility of the 'no conflict' rule may, depending on the facts of any given case, work harshly so far as the fiduciary is concerned. It may be said with force that that is the inevitable and intended consequence of the deterrent nature of the rule. On the other hand, it may be said that commercial conduct which in 1874 was thought to imperil the safety of mankind may not necessarily be regarded nowadays with the same depth of concern. So, like Arden LJ (see paragraph 82 above), I can envisage the possibility that at some time in the future the House of Lords may consider that the time has come to relax the severity of the 'no conflict' rule to some extent in appropriate cases.

122. In my judgment, however, that day has not yet arrived. Nor, in any event, would I regard the instant case as being an appropriate case for any such relaxation. …

CLARKE LJ:

124. With one important exception, I agree with the conclusions reached by Arden LJ. That exception relates to the principles applicable to the taking of an account in a case of this kind. I have reached the conclusion that the principles applicable to the correct approach to the amount of the **(p. 419)** profits in

respect of which an account should be ordered are more flexible than Arden LJ suggests. …

138. Whatever the position with regard to equitable compensation, which the Murads do not claim, the cases relevant to the obligation to account for a breach of fiduciary duty provide a strong basis for Arden LJ's conclusion that Mr Al-Saraj should account for the whole of the profit which derived from the joint venture. However, Mr Cogley submits that, notwithstanding the strong statements of principle in the cases, including those which say that causation is irrelevant and that it is irrelevant what the principal or person to whom the fiduciary duty is owed would have done if full disclosure had been made, some element of causation must be established …

162. In all these circumstances I have reached a different conclusion from Arden LJ. I would hold that the finding that the Murads would have entered into this joint venture in any event is relevant to the scope of the account which should be ordered. The judge did not so hold because he regarded the finding as irrelevant because of equity's inflexible rule. In these circumstances, subject to hearing submissions as to the precise scope of the remission, I would remit the matter to the judge in order to give Mr Al-Saraj the opportunity to seek to persuade him that it would be inequitable to order him to account for all the profits of the joint venture, subject only to his expenses and skill. I would therefore allow the appeal to that extent.

➢ Questions

1. When is an account of profits awarded? When is equitable compensation awarded? How is each quantified?

2. How did Arden and Jonathan Parker LJJ distinguish the approach to quantifying (and cutting back) the recoverable profits in *Warman* (earlier) from the approach they felt obliged to take on the facts before them? Is their approach more satisfactory than that of Clarke LJ?

3. Do the rules on account of profits need to be relaxed? (See Arden and Clarke LJJ, at [81]–[82] and [121]–[122], in the previous extract.) Also see the comments of Arden LJ in *Geoffrey Maidment v Allan Attwood, Nicola Heard, Tobian Properties Limited* [2012] EWCA Civ 998, CA, an unfair prejudice case, where she cited *Murad***[7.35]** and noted that 'This is a harsh result. Equity has not developed exceptions to avoid this because there is a strong deterrent element in the imposition of liability for breach of fiduciary duty' [22].

4. In *Murad*, S and W also submitted that the proper claimant in respect of any alleged secret commission paid to S on the acquisition of the hotel was D, but the Court of Appeal did not decide this matter. What is the right answer? In any event, would *S and W* be allowed to benefit from any successful recovery by D? (The question was remitted to the trial judge for determination in [2006] EWHC 2404 (Ch), but D made no claim to the sum, therefore the sum remained owing to M.)

5. This same strict approach is also applied to assessing the profits which have to be disgorged in actions against third parties who knowingly assist in a fiduciary's breach of fiduciary duty: see Andrew Smith J in *Fiona Trust & Holding Corporation v Privalov* [2011] EWHC 664 (Comm), this decision being one very small part of major litigation concerning fraud and bribery in the Russian shipping industry.

[7.36] JJ Harrison (Properties) Ltd v Harrison [2001] EWCA Civ 1467, [2002] 1 BCLC 162 (Court of Appeal)

H, a director of HP, acquired land from HP without making the necessary disclosures. He then argued that the claim against him was statute barred. The Court of Appeal held that **(p. 420)** HP's claim fell within s 21(1)(b) of the Limitation Act 1980—ie an action 'to recover trust property or the proceeds of trust property previously received by the trustee and converted to his use'—and therefore was not statute barred. It also ordered an account of profits on the value of the land (now resold).

CHADWICK LJ:

The constructive trust issue

25 I start with four propositions which may be regarded as beyond argument: (i) that a company incorporated under the Companies Acts is not trustee of its own property; it is both legal and beneficial owner of that property; (ii) that the property of a company so incorporated cannot lawfully be disposed of other than in accordance with the provisions of its memorandum and articles of association; (iii) that the powers to dispose of the company's property, conferred upon the directors by the articles of association, must be exercised by the directors for the purposes, and in the interests, of the company; and (iv) that, in that sense, the directors owe fiduciary duties to the company in relation to those powers and a breach of those duties is treated as a breach of trust. …

26 It follows from the principle that directors who dispose of the company's property in breach of their fiduciary duties are treated as having committed a breach of trust that a person who receives that property with knowledge of the breach of duty is treated as holding it upon trust for the company. He is said to be a constructive trustee of the property. …

27 It follows, also, from the principle that directors who dispose of the company's property in breach of their fiduciary duties are treated as having committed a breach of trust that, a director who is, himself, the recipient of the property holds it upon a trust for the company. He, also, is described as a constructive trustee. But, as Millett LJ explained in *Paragon Finance plc v Thakerar & Co* [1999] 1 All ER 400, at pp 408g–409g, his trusteeship is different in character from that of the stranger. He falls into the category of persons who, in the words of Millett LJ (at [1999] 1 All ER 400, 408j)

… 'though not strictly trustees, were in an analogous position and who abused the trust and confidence reposed in them to obtain their principal's property for themselves.'

28 Millett LJ referred to persons within that category—that is to say, persons who had abused their powers so as to obtain their principal's property for themselves—as 'persons [who] are properly described as constructive trustees'. He went on to say this:

> 'Regrettably, however, the expressions "constructive trust" and "constructive trustee" have been used by equity lawyers to describe two entirely different situations. The first covers those cases already mentioned, where the defendant, though not expressly appointed a trustee, has assumed the duties of a trustee by a lawful transaction which was independent of and preceded the breach of trust and is not impeached by the plaintiff. The second covers those cases where the trust obligation arises as a direct consequence of the unlawful transaction which is impeached by the plaintiff.
>
> A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of property (usually but not necessarily the legal estate) to assert his own beneficial interest in the property and deny the beneficial interest of another. In the first class of case, however, the constructive trustee really is a trustee. He does not receive the trust property in his own right but by a transaction by which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by means of which he obtained it, and his subsequent appropriation of the property to his own use is a breach of that trust …
>
> The second class of case is different. It arises when the defendant is implicated in a fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a constructive trustee and said to be "liable to account as a constructive trustee". Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. …'

(p. 421) 29 There is no doubt that Millett LJ regarded it as beyond dispute that a director who obtained the

company's property for himself by misuse of the powers with which he had been entrusted as a director was a constructive trustee within the first category … The reason is that a director, on appointment to that office, assumes the duties of a trustee in relation to the company's property. If, thereafter, he takes possession of that property, his possession 'is coloured from the first by the trust and confidence by means of which he obtained it'. His obligations as a trustee in relation to that property do not arise out of the transaction by which he obtained it for himself. The true analysis is that his obligations as a trustee in relation to that property predate the transaction by which it was conveyed to him. The conveyance of the property to himself by the exercise of his powers in breach of trust does not release him from those obligations. He is trustee of the property because it has become vested in him; but his obligations to deal with the property as a trustee arise out of his pre-existing duties as a director; not out of the circumstances in which the property was conveyed.

30 In the present case the deputy judge found that … Mr Harrison acted in breach of his fiduciary duties as a director in failing to ensure that the land was sold at its full value … Not only did Mr Harrison fail to make a proper disclosure of his interest; his existing duties as a director required him to ensure that the development land was not conveyed at all until the company had received and considered advice as to its value in the light of the change in planning potential. In those circumstances it seems to me impossible to reach a conclusion that Mr Harrison did not hold the development land as a constructive trustee, in the sense described by Millett LJ in the first of the two categories identified [earlier]. …

49 On the basis that Mr Harrison held the development land as trustee for the company, the remedy sought by the cross-appeal is an order that he account for the value of the land as at 23 December 1988—that being the date of the sale of the barn.

50 It seems to me right that Mr Harrison should account for the £110,300 which he received on that sale. He should be entitled to bring to the credit of that account a proportionate part of the £8,400 which he paid for the development land and the cost of any works which led to an enhancement in the value of that part of the land. It is pertinent to have in mind that the costs of pursuing planning applications has already been borne by the company.

51 I am not persuaded, however, that it would be right to require Mr Harrison to account for the value of the remainder of the development land—that is to say, the site of the replica Elizabethan manor house—at its 1988 value [which was a higher value than at the time of its sale, later on]. …

52 In the absence of any evidence that the value of the development land as a whole was diminished by the sale of part in December 1988, it seems to me that the appropriate order is to require the value of the manor house site to be brought in at the price (£122,500) obtained on the further sale in April 1992. Again Mr Harrison can bring to the credit of that account the balance of the £8,400 and the cost of any works which led to an enhancement in the value of that part of the land. Subject to the proviso that he is not to take credit for expenditure which did not preserve or lead to an enhancement in the value of the land, the question what costs and allowances can be set off against the proceeds of sale will be determined on the taking of the account. …

LAWS LJ and SIR ANTHONY EVANS concurred.

➢ Note

This case involved a contract between the defaulting director and his company (where the normal remedy for the director's undisclosed conflict is rescission, with the asset held by the director on constructive trust until the legal title is retransferred to the company). But the constructive trust remedy is also available where the defaulting director deals with third parties and takes a corporate opportunity (see *Cook v Deeks* **[7.22]**). In these corporate opportunity cases, however, an account of profits remedy is often seen as preferable whenever the constructive trust would overcompensate the company given the real extent of the profit arising

from the breach (see the discussion in *Murad* **[7.35]** of the approach taken by the **(p. 422)** Australian High Court in *Warman International Ltd v Dwyer*). Alternatively, the constructive trust remedy can be moderated by permitting 'a liberal allowance' for the fiduciary's input in generating the profit (see *Boardman v Phipps* [1967] 2 AC 46, HL, but contrast *Guinness plc v Saunders* **[5.01]**).

Account of profits and equitable compensation—rules on disclosure that will exempt the breach, quantification of the account of profits and effect of the Limitation Act 1980 s 21(1)(a).

[7.37] Gwembe Valley Development Co Ltd v Koshy [2003] EWCA Civ 1048, [2004] 1 BCLC 131 (Court of Appeal)

K, the managing director of joint venture company G, was ordered to account to G for unauthorised profits he had made from loan transactions which he had arranged for G. The transactions involved L, an investor in G which was controlled by K. Both K and L made large profits from the transactions. K was liable to account because he had made an unauthorised profit from his fiduciary position and because he had dishonestly, and in breach of fiduciary duty, procured G to enter into the transactions with L without properly disclosing to G's other directors or shareholders that he and L would make vast profits and the nature of his involvement with L.

K could not rely on G's articles of association to exempt him from the rule against self-dealing because he had not made a formal disclosure to the board, as required by the articles. No limitation period applied to G's claim for an account of the profits by K because the action was analogous to an action for 'fraud or fraudulent breach of trust' within the meaning of the Limitation Act 1980 s 21(1)(a). The scope of the account of profits was not limited; a general account of profits should be ordered.

MUMMERY LJ for the court (MUMMERY, HALE and CARNWATH LJJ):

Core issues

1. Despite the thickets of company law, contract, fiduciary law, limitation of actions and equitable remedies, which have grown around this case, the central questions for decision can be stated quite concisely: between 1986 and 1988 did the managing director of a joint venture company deliberately and dishonestly fail to disclose his personal interest in transactions with the company and, if so, is he liable to account to the company for all, or for only part of, the unauthorised profits made by him; alternatively, did that failure to disclose his interest render him liable to compensate the company for its losses in the joint venture? …

Brief overview

2. In 1986 a joint venture was formed in Zambia. Its aim was to develop a cotton and wheat farm of 2,500 hectares at Sinazongwe on the shores of Lake Kariba. A group of investors funded the project. Each investor was allowed representation on the board of Gwembe Valley Development Company Limited (GVDC), a Zambian company incorporated in November 1985 as the corporate vehicle for the project. Representation on the board was proportionate to the size of the investment. There were no outside 'independent' directors.

3. The venture faltered. The investors fell out. GVDC became insolvent. The project collapsed. Litigation broke out …

5. The relief claimed in the GVDC action included an account of profits made by its managing director, Mr Thomas Koshy. He is an accountant. Alternative claims were made against him for equitable compensation for breaches of fiduciary duty and for damages for deceit and conspiracy. A declaration was also sought that Mr Koshy and a company controlled by him (Lasco) were liable as constructive trustees of all GVDC's money received by them …

(p. 423) 19. The essential point in all the claims against Mr Koshy is that he was at the same time both the managing director of GVDC, in which the majority interest was held by Lasco, and a director and the

controlling shareholder of Lasco …

26. It was alleged by GVDC that Mr Koshy had breached his fiduciary duties by procuring GVDC to enter into … loan transactions for his own purposes, knowing that they were not in the best interests of GVDC. Their effect was that Mr Koshy and Lasco could treat GVDC as liable to pay $US 5.8m on demand. Mr Koshy later procured GVDC to repay to Lasco substantial sums in respect of that purported debt. It was claimed that an award of equitable compensation should be made to restore GVDC to the position it was in prior to the pipeline loan transactions …

Basis of liability

43. Rimer J concluded that Mr Koshy was liable to account to GVDC for profits made by him from the pipeline loan transactions … Mr Koshy's liability arose in two ways: (1) Under the 'no profit rule' i.e. the rule of equity that a company director may not make an unauthorised (secret) profit from his fiduciary position …; (2) Dishonest breaches of fiduciary duty i.e. dishonestly using his position as managing director of GVDC to procure, in his own interests rather than in the interests of the company, GVDC to enter into the pipeline loan transactions, while deliberately not disclosing to the other directors and to the shareholders of GVDC his controlling interest in Lasco and the scale of Lasco's, and his, intended profit from the transactions … The judge found that the non-disclosure was deliberate, that it was part of Mr Koshy's dishonest scheme to benefit himself and that it involved the misapplication of GVDC's assets.

The no profit rule

44. The relevant principle was forcefully expressed and elegantly explained in the joint judgment of Rich, Dixon and Evatt JJ in the High Court of Australia in *Furs Ltd v. Tomkies* (1936) 54 CLR 583 at 592 as:

> '… the inflexible rule that, except under the authority of a provision in the articles of association, no director shall obtain for himself a profit by means of a transaction in which he is concerned on behalf of the company unless all the material facts are disclosed to the shareholders and by resolution a general meeting approves of his doing so or all the shareholders acquiesce. An undisclosed profit which a director so derives from the execution of his fiduciary duties belongs in equity to the company. It is no answer to the application of the rule that the profit is of a kind which the company itself could not have obtained, or that no loss is caused to the company by the gain of the director. It is a principle resting upon the impossibility of allowing the conflict of duty and interest which is involved in the pursuit of private advantage in the course of dealing in a fiduciary capacity with the affairs of the company. If, when it is his duty to safeguard and further the interests of the company, he uses the occasion as a means of profit to himself, he raises an opposition between the duty he has undertaken and his own self interest, beyond which it is neither wise nor practicable for the law to look for a criterion of liability. The consequences of such a conflict are not discoverable. Both justice and policy are against their investigation.'

45. That is the same equitable doctrine of accountability for unauthorised profits as was applied by the House of Lords in *Regal (Hastings) Ltd v. Gulliver* **[7.23]** …

Exemption under the articles through disclosure

46. Mr Koshy denied that he was under any duty to account to GVDC under the strict 'no profit rule' [because] … he was expressly exempted by Article 89 of the Articles of Association of GVDC from the strict duty to account to the company for the profits made from the pipeline loan transactions, even if he had made no disclosure to the board of his personal interest in the transactions or of his profits; and that (b) the disclosure in fact made by him was sufficient for that purpose and under the general law …

(p. 424) 51. We are unable to accept this submission. It is necessary to read Article 89 in its proper context and, in particular, in conjunction with Article 88, which requires a formal declaration of interest to be made by a director at a meeting of the board of the company …

52. In *Movitex v. Bulfield* [1988] BCLC 104, where the relevant Articles were in similar form …, Vinelott J treated the general exclusion of the self-dealing rule in the Articles as subject to the duty of the director to declare his interest in a transaction to be entered into by the company. The self-dealing rule was not excluded by the Articles, if the director's interest was not disclosed in accordance with the Articles: see p114e–g …

Implied modification of fiduciary duty

55. Mr Koshy's second ground of appeal under this head also emphasised the special joint venture character of GVDC. It was submitted that none of the members of the board of GVDC would expect other members of the board to disclose their principal's profits from transactions with GVDC. The board was made up of representatives of the investors … It was not intended to be an independent board. The directors did not owe fiduciary obligations to GVDC in respect of transactions between the principals they represented and GVDC. In particular, it was argued that the directors of GVDC were well aware that Mr Koshy had a conflict of interest and was making a personal profit. It was to be implied from all the circumstances that the fiduciary's duty of disclosure of interests in relation to transactions with the company was excluded.

56. This argument should be rejected. It has no valid factual or legal basis …

Disclosure under the general law

64. Rimer J held that Mr Koshy failed to make sufficient disclosure in order to avoid liability to account under the general law for breach of fiduciary duty, as distinct from being exempted from the duty to account by making formal disclosure of his interest under the Articles.

65. The requirement of the general law is that, although disclosure does not have to be made formally to the board, a company director must make *full* disclosure to all the shareholders of all the material facts. The shareholders in the company, to which he owes the fiduciary duty not to make an unauthorised profit from his position, must approve of, or acquiesce in, his profit. Disclosure requirements are not confined to the nature of the director's interest: they extend to disclosure of its extent, including the source and scale of the profit made from his position, so as to ensure that the shareholders are 'fully informed of the real state of things,' as Lord Radcliffe said in *Gray v. New Augarita Porcupine Mines* [1952] 3 DLR 1 at 14.

66. Rimer J held that Mr Koshy, on whom the onus of proving full disclosure to shareholders lay, fell short of the requirements of the general law …

Dishonest breach of fiduciary duty

69. Mr Koshy challenged the evidential basis for the judge's findings of fact under the second head of liability to account for profits made from dishonest breaches of fiduciary duty in relation to the pipeline loan transactions.

70. Rimer J found that Mr Koshy had pursued a fraudulent scheme of deliberate concealment from GVDC … The non-disclosure of his profits from the pipeline loan transactions was, he found, deliberate and dishonest. That was a grave finding of fact. It is particularly relevant to Mr Koshy's limitation defences to an account of profits …

Limitation and claims in equity: general

71. Is GVDC's action against Mr Koshy for an account of profits time-barred? This seemingly straightforward question has led the parties to a prolonged and intricate analysis of the provisions of section 21 of the Limitation Act 1980, which contains special rules for 'actions in respect of trust property' …

78. The basis of GVDC's case against Mr Koshy was that he had acted in breach of the 'no profit' rule binding on him as a director of the company, and had done so dishonestly. The **(p. 425)** time-limit relied on by GVDC as applicable to such a claim is that in section 21. That section provides:

'**(1)** No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action—

(a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
(b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use.

(2) [Omitted as immaterial]
(3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a limitation period is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued.' …

81. The effect of section 36 is to preserve, except as indicated, the cases in which a court of equity would have applied the statutory limitation periods by analogy …

Fiduciary duties and limitation—summary

111. In the light of those cases [authorities cited in the judgment but not extracted here], in our view, it is possible to simplify the court's task when considering the application of the 1980 Act to claims against fiduciaries. The starting assumption should be that a six year limitation period will apply—under one or other provision of the Act, applied directly or by analogy—unless it is specifically excluded by the Act or established case-law. Personal claims against fiduciaries will normally be subject to limits by analogy with claims in tort or contract (1980 Act s 2, 5 …). By contrast, claims for breach of fiduciary duty, in the special sense explained in*Mothew*, will normally be covered by section 21. The six-year time-limit under section 21(3), will apply, directly or by analogy, unless excluded by subsection 21(1)(a) (fraud) or (b) (Class 1 trust) [.]

112. In the present case, it is clear that these principles were applicable to a director in Mr Koshy's position. He had 'trustee-like responsibilities' in the exercise of the powers of management of the property of GVDC and in dealing with the application of its property for the purposes, and in the interests, of the company and of all its members. In our view, accordingly, the claim for an account, if it was based on a failure in the exercise of those responsibilities, was within the scope of section 21. It was in principle subject to a six-year time-limit under section 21(3). The question is whether it was excluded under either of the two statutory exceptions in section 21(1)(a) and (b) …

The arguments in the Court of Appeal

120. … in our view, GVDC's case cannot be b[r]ought within section 21(1)(b). It stands or falls on section 21(1)(a), and that depends on establishing fraud …

121. Accordingly, with respect to the impressive learning and industry displayed on both sides, and the many ways in which the various arguments have been put, the determinative issue on this part of the case is the short, but difficult, question whether the breach of fiduciary duty was fraudulent. In other words, was Mr Koshy guilty of simple non-disclosure or of deliberate and dishonest concealment? …

Conclusions on dishonesty

131. In *Armitage v. Nurse* [1998] Ch 241 at 251D, 260G Millett LJ held that, in this context, a breach of trust is fraudulent, if it is dishonest. He accepted counsel's formulation that dishonesty—

'… connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the company or being recklessly