The nature of the remedy of account for unauthorised profits

The proper approach to the nature of the remedy when a fiduciary acquires an unauthorised profit is set out by Rimer J in *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd (No 3)*¹ and by Lawrence Collins J in *CMS Dolphin Ltd v. Simonet*,² as set out variously below.³ The remedy has always been generally described by the courts on the basis that the fiduciary is “liable to account” to the beneficiaries for the unauthorised profit. The question then is: what is meant by the obligation to account? It could relate either to a proprietary right in relation to the profits themselves or simply a personal obligation to pay an amount of money equal to the profits earned.

Rimer J has explained this doctrine accurately in *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd (No 3)*⁴ in the following terms:

“… any identifiable assets acquired by fiduciaries in breach of their fiduciary duty are, and can be declared to be, held upon constructive trust for the principal *(Boardman v Phipps, AG Hong Kong v Reid, Daraydan Holdings Ltd v Solland)* … There will in practice often be no identifiable property which can be declared by the court to be held upon such a constructive trust, in which case no declaration will be made and the principal may at most be entitled to a personal remedy in the nature of an account of profits. In *Boardman’s* case the court made a declaration that the shares that had been acquired by the fiduciaries were held on constructive trust (a proprietary remedy), and directed an account of the profits that had come into their hands from those shares (a personal remedy). *Boardman’s* case can be said to have been a hard case as regards the fiduciaries, whose integrity and honesty was not in doubt; and it well illustrates the rigours of the applicable equitable principle. The recovery by the trust of the shares was obviously a valuable benefit to it; and equity’s softer side was reflected in the making of an allowance to the fiduciaries for their work and skill in obtaining the shares and profits. On the very different facts of *Reid’s* case, there was no question of any such allowance being made.”

Therefore, the position is clear: the primary remedy is for a proprietary constructive trust over the personal profits; the secondary remedy (if there is no property over which the constructive trust can take effect) is for a personal remedy in the form of an account of profits; and thirdly the court may make some equitable accounting to reduce the amount of any such account if the court considers the circumstances to be appropriate for the equitable relief of such a defendant.⁵

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¹ [2007] EWHC 915, 10 ITELR 58.
² [2001] 2 BCLC 704.
³ This discussion is set out below at the end of this section in relation to the “corporate opportunity doctrine” in company law.
⁴ [2007] EWHC 915, 10 ITELR 58.
⁵ See also *Markel International Insurance Co Ltd v Surety Guarantee Consultants Ltd* [2008] EWHC 1135 (Comm) illustrating the principle that secret profits made by a fiduciary must be accounted for.
The primary form which the liability to account takes is in the form of a constructive trust, whereby a proprietary right is imposed over those profits such that the fiduciary becomes a constructive trustee over those profits. Because the claimant-beneficiary\(^6\) acquires a proprietary right over the profits, that beneficiary also has a proprietary right over any property that is acquired with those profits. This constructive trust right also means that even if those profits are mixed with other money, then the beneficiary acquires a right to trace into that mixture or into any substitute property and to impose a proprietary right over it, as discussed in Chapter 19 *Tracing*. The secondary form which the liability to account takes is predicated on the idea either that the profits cannot be traced or that the property substituted for the profits can be traced but has become worthless. In such a situation, the proprietary right would be worthless. In this second context, the fiduciary’s liability is to account for the amount of the unauthorised profits personally by paying money or money’s worth to the trust equal to the amount of the profits. This chapter focuses primarily on the constructive trust.

However, perhaps the easiest way to understand how this head of liability works is to think about what it means to be a “constructive trustee”. A “constructive trust” is a trust which the court “construes” or “constructs” in circumstances in which the legal owner of property has behaved unconscionably in relation to property. Thus, a “constructive trustee” is a person who is construed to be a trustee. There is an important distinction between a fiduciary’s liability to account for unauthorised profits and the liability of an express trustee to account for breach of trust (where the latter liability is based on the decision of the House of Lords in *Target Holdings v Redfern*\(^7\)). An express trustee is liable to reconstitute the trust fund and to compensate the beneficiaries for any loss which flows from a breach of trust; whereas a fiduciary’s liability to account for unauthorised profits does not require that the beneficiaries have suffered a loss. So, in the leading case of *Boardman v Phipps*\(^8\) the beneficiaries had suffered no loss but were nevertheless entitled to force Boardman to account for his unauthorised profits. Consequently this is not a restitutionary remedy because the fiduciary need not have earned her profits at the beneficiaries’ expense, as the theory of restitution of unjust enrichment requires. Instead, it is enough that the equitable wrong of earning unauthorised profits from a fiduciary office has been committed. The basis of this liability is predicated on an actual or even a potential conflict between the fiduciary’s personal interests and her fiduciary office.\(^9\) The fiduciary must then account for those profits by means of a constructive trust or secondarily by means of a personal liability to account.

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\(^6\) The “claimant-beneficiary” in relation to fiduciary duties generally is a general reference to whoever takes the benefit of that fiduciary relationship, whether a beneficiary under a trust or the company in relation to a director, as so forth.

\(^7\) [1996] 1 AC 421.

\(^8\) [1967] 2 AC 46.

\(^9\) E.g. *Boardman v Phipps* [1967] 2 AC 46.