

CASE DIGEST

ALEXANDER HEYLIN

Enterprise
CHAMBERS

RUKHADZE V RECOVERY PARTNERS GP LTD [2025] UKSC 10

KEY TAKEAWAYS:

1. In respect of the test for requiring an account of profits, the court does not and should not concern itself with what might have happened in a hypothetical "but for" situation.
2. The question to ask is "did the profit owe its existence to a significant extent to the application by the fiduciary of property, information or some other advantage which he enjoyed as a result of his fiduciary which the conflict duty required him to avoid altogether" (Lord Briggs at paragraph 36).
3. There is no justifiable reason to depart from the long-established principles in this area of law.
4. The introduction of a "but for" test would undermine the essential purpose of the profit rule by treating it as a mere remedy and thus watering down its disincentivising effect.
5. The existing scope for an equitable allowance to be afforded mitigates any excessive harshness.

ISSUE

Whether the current test for requiring an account of profits should be altered to introduce a requirement that the fiduciary could not have made the same profit in a way that avoided a breach of duty, ie: 'Could the same profit have been made **but for** the breach of fiduciary duty'?

FACTUAL BACKGROUND

The Respondent is a company incorporated in the British Virgin Islands (to which the claims of another such company have also been assigned) and an English LLP. The Appellants worked for the Respondents, holding positions of responsibility such that they owed fiduciary duties to the Respondents. In breach of those duties, the Appellants diverted a business opportunity away from the Respondents and exploited it for themselves.

Following a claim in the High Court, the Appellants were, in accordance with the profit rule, ordered to pay to the Respondents the profits made from the business opportunity. The Appellants appealed, unsuccessfully, to the Court of Appeal.

'PROFIT RULE'

Fiduciaries, such as trustees or company directors, owe a **duty of loyalty** to their beneficiary/principal.

One of the ways in which this duty of loyalty manifests itself is in a requirement that, if the fiduciary makes a profit out of their position as a fiduciary, they are bound to account for that profit to their principal (unless the principal has given fully informed consent).

Profits made from the fiduciary relationship are treated by equity as **held upon constructive trust** for the principal from the moment of their receipt by the fiduciary.

The duty exists in its own right and is not just a remedy.

HOUSE OF LORDS AUTHORITIES

Boardman v Phipps
[1967] 2 AC 46

STARTING POINT

"Rules of equity have to be applied to such a great diversity of circumstances that they can be stated only in the most general terms and applied with particular attention to the exact circumstances of each case."

PROPHYLACTIC ROLE OF CONFLICT AND PROFIT RULES

"The relevant rule for the decision of this case is the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict."

Regal (Hastings) Ltd v Gulliver [1967] 2 AC 134

DUTY EXISTS IN ITS OWN RIGHT AND IS NOT JUST A REMEDY

"The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account."

SUPREME COURT JUDGMENT

The Supreme Court UNANIMOUSLY DISMISSED the appeal and declined the Appellants' invitation to change this aspect of the law.

LORD BRIGGS - MAJORITY JUDGMENT

(WITH WHOM LORDS REED, HODGE AND RICHARDS AGREED)

NATURE OF THE OBLIGATION

The obligation to account is a duty imposed by equity. It is not necessarily (though it often is) triggered by a separate breach of duty and it is certainly not a mere discretionary remedy for such a breach, dependent on a demand from the principal or an order of court (though it often has a remedial effect).

An account of profits is not comparable to an award of damage nor equitable compensation (which does employ a 'but for' test) as it is not about compensation for loss.

PURPOSE OF THE OBLIGATION

The essential purpose of the profit rule is to deter fiduciaries from giving into the human temptation to depart from their obligation of single-minded loyalty to their principal (for their own benefit).

Thus, the introduction of a 'but for' test would undermine the essence of the duty, by treating it as a mere remedy for a separate breach, and water down the chief disincentive - the inevitable nature of the obligation to account for profits - for fiduciaries who might otherwise be tempted to be disloyal.

EXISTING LAW

His Lordship found that there was:

NO justifiable reason to depart from long-established legal principles;

NO compelling divergence between the approach taken by the English courts and those of other common law jurisdictions; and

NO academic consensus in favour of changing the law in the way the appellants suggested.

His Lordship also highlighted that an effective means of mitigating against any excessive harshness already existed, namely the scope for an equitable allowance to be afforded to errant fiduciaries in recognition of their work and skill in obtaining the profits.

LORD LEGGATT

TRUE RULE

Reference to the 'profit rule' is misleading.

True rule = a fiduciary must not use any property belonging to the principal for their own benefit or any unauthorised purpose.

If the fiduciary does so, he or she is liable to compensate the principal for any loss caused, or to account to the principal for any profit made, as a result of the breach of duty.

'BUT FOR' TEST

A 'but for' test is inherent in the requirement to show the causal link between the breach of duty and a recoverable loss or profit and was satisfied.

The appellants exploited for themselves a business opportunity (and confidential information) in breach of fiduciary duties owed to the respondents. But for these breaches, they would not have made any of the profits which they in fact made.

ACCOUNT OF PROFITS MERELY A REMEDY

Lord Leggatt disagreed with Lord Briggs' characterisation of an account of profits as a duty rather than just a remedy.

LORD BURROWS

REMEDY IN THIS CASE

Account of profits a remedy for the wrong of breach of fiduciary duty in this case.

CAUSAL TEST

The two leading cases do not apply a 'but for' test to link the profits made to the wrong because the causal test does not incorporate a consideration of the profits which the defendant might otherwise have lawfully obtained.

CAUTION IN OVERRULING AUTHORITY

Invitations to overrule Supreme Court/House of Lords authority are approached with caution.

The two leading cases cannot be said to have been plainly wrong in their failure to apply a 'but for' test that includes the 'lawful alternative counterfactual' (i.e. the test contended for by the appellants).

The approach in those two cases can be readily justified for reasons of principle and policy and should not be overruled.

LADY ROSE

MATTER FOR PARLIAMENT

The appellant's real complaint is that the formal roles that the parties were given in companies and partnerships did not reflect their actual business relationships or the conduct fairly expected of them, but were adopted purely for tax advantage etc.

Those rules were recently codified in the Companies Act 2006.

It shows that Parliament did not consider that changing business norms in the UK, which is where these parties were carrying on business, meant that the traditional equitable rules were now out of date.

Further, the proposed change to the law would have far reaching effects.

Any reconsideration was properly a matter for the legislature.

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It does not constitute legal advice and reflects the law as at 16 April 2025.

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