accepted, for the purposes of these proceedings, that they were in breach of their duty to exercise reasonable care and skill in carrying out their responsibilities as auditors and that, but for their breach, the fraud perpetrated by S & R would have been discovered earlier. MS submitted, however, **(p. 166)** that the action could not succeed because it was founded on S & R's fraud and was met by the defence of *ex turpi causa*. S & R argued that its liability for S's frauds was vicarious; that by reason of the principle in *Re Hampshire Land Co* **[3.31]** S's fraud could not be attributed to it; and that *ex turpi causa* did not provide a defence where the claimant's illegal conduct was the very thing that the defendant was under a duty to prevent. The House of Lords (Lords Scott and Mance dissenting) found for MS, holding the auditors not liable in the circumstances.

LORD PHILLIPS OF WORTH MATRAVERS:

12 The debate between the parties has largely centred on the nature and effect of the *Hampshire Land* principle. Mr Sumption [counsel for MS] summarised this principle as follows in oral argument: 'There is not to be imputed to a company a fraud *which is being practised against it* even if it is being practised by someone whose acts and state of mind in the ordinary way are attributed to the company.' [Emphasis added.] Mr Sumption submits that this principle does not prevent attribution to S & R of Mr Stojevic's fraud which was directed not against S & R but against the banks.

13 Mr Brindle [counsel for S & R] does not accept that the *Hampshire Land* principle is as narrow as this. He submits that it also applies in respect of fraud on the part of an agent of the company that is directed against a third party in as much as the fraud is likely ultimately to come home to roost with consequent detriment to the company. Thus the company is a secondary victim of the fraud. That is precisely what has happened in this case, for S & R has been held liable [to the banks] for Mr Stojevic's fraud.

14 Mr Sumption has a fallback position that meets this argument. It turns on the fact that Mr Stojevic was, in effect, the sole shareholder in S & R and also solely responsible for S & R's activities. Mr Sumption submits that where there is no human embodiment of the company other than the fraudster, attribution of the fraud to the company is inevitable. …

43 … The important point to note is that *Hampshire Land* **[3.31]** is an exception to the normal rules for the attribution of an agent's *knowledge* to his principal. It is not a rule about the attribution of conduct. *Hampshire Land* applies where an agent has knowledge which his principal does not in fact share but which under normal principles of attribution would be deemed to be the knowledge of the principal. The effect of *Hampshire Land* is that knowledge of the agent will not be attributed to the principal when the knowledge relates to the agent's own breach of duty to his principal. The rationale for *Hampshire Land* has been said to be that it is contrary to common sense and justice to attribute to a principal knowledge of something that his agent would be anxious to conceal from him. …

49 … The purpose for which the question of attribution has to be answered is in order to decide whether the defence of *ex turpi causa* applies. … If the underlying principle of public policy is applied, the question that has to be answered is whether S & R is seeking to obtain compensation for the consequences of its own fraud rather than for the consequences of fraud for which it is only vicariously liable. To answer the question it is necessary to decide whether the fraud of Mr Stojevic falls to be treated as the fraud of S & R itself …

60 … It makes no sense to say that the fraud should not be attributed to the company. The fact that fraud has been attributed to the company is the very thing about which the company is complaining. The company's complaint is that its directing mind and will has infected it with turpitude. If *ex turpi causa* is not to apply in such circumstances, the reason should simply be that the public policy underlying it does not require its application.

61 One can readily reach that conclusion where all the shareholders are innocent. Recovery from the directing mind and will [ie by the company against the defaulting director] does not result in any individual recovering compensation for his own wrong. The position becomes unclear, however, if some of the shareholders were complicit in the directing mind and will's misconduct …

65 Lord Brown and Lord Walker have based their decision on Mr Sumption's fallback position. Lord Walker

identifies the reason for the *Hampshire Land* principle to be that it would be 'unjust to its innocent participators (honest directors who were deceived, and shareholders who were cheated)' to fix a company with its directors' fraudulent intention. Where there are no honest directors or **(p. 167)** shareholders there is 'ex hypothesi no innocent participator'. It follows that there is no room for the application of *Hampshire Land*.

66 Lord Scott and Lord Mance do not accept this analysis. They would include among the 'innocent participators' the creditors of a company in circumstances where the company is insolvent or is threatened with insolvency. They postulate that the duty owed by auditors is owed for the benefit of these participators also, and that*ex turpi causa* should not defeat a claim brought for their benefit.

67 For the reasons that I have already given, I consider that the real issue is not whether the fraud should be attributed to the company but whether *ex turpi causa*should defeat the company's claim for breach of the auditor's duty. That in turn depends, or may depend, critically on whether the scope of the auditor's duty extends to protecting those for whose benefit the claim is brought …

LORD SCOTT OF FOSCOTE (dissenting):

105 These remarks of Lord Hoffmann [in *Meridian Global* **[3.29]**, cited in the earlier extract] have, as it seems to me, a particular resonance in the present case. Your Lordships have not been shown the memorandum of association or the articles of association of S & R nor the power of attorney granted to Mr Stojevic. It may reasonably be assumed, I think, that the articles gave the directors power to grant a power of attorney to Mr Stojevic to enable Mr Stojevic to take management decisions on behalf of S & R. But it may confidently be asserted … [that] Mr Stojevic's actions in using S & R as a vehicle for implementing the fraudulent scheme he had devised would have been outside the powers conferred on him by the power of attorney. This feature of the relationship between Mr Stojevic and S & R has no relevance whatever so far as dealings between S & R and those defrauded by the scheme are concerned. They were entitled to hold S & R liable for the frauds in which S & R had participated. But it does have relevance, in my opinion, to the question whether S & R was itself a victim of Mr Stojevic's fraudulent scheme and, thus, to the critical question whether, for the purposes of S & R's action against Moore Stephens, Mr Stojevic's dishonesty should be attributed to S & R.

106 *In re Hampshire Land* established the rule that the knowledge of an officer of a company of his own fraud or breach of trust directed at third parties will not necessarily be imputed to that company … In particular, if the director in breach of duty has an adverse interest to that of the company, the knowledge of the breach of duty will not be imputed to the company: see *JC Houghton & Co v Nothard Lowe & Wills Ltd* [1928] AC 1, 19 where Viscount Sumner said that it would be 'contrary to justice and common sense to treat the knowledge of such persons as that of their company, as if one were to assume that they would make a clean breast of their delinquency'.

107 There are, however, cases, sometimes referred to as 'sole actor' cases, where the company has no human embodiment other than the fraudster and where, therefore, there is no one in the company for the fraudster to deceive, no one in the company to whom 'a clean breast of … delinquency' could be made. In these 'one actor' cases, it is said, the *Hampshire Land Co* rule can have no sensible application. The knowledge of the fraudster simply *is* the knowledge of the company. An example of this proposition in action is *Royal Brunei Airlines Sdn Bhd v Tan* **[7.43]**. This was a case in which the issue was whether the company, BLT, had been guilty of fraud or dishonesty in relation to money it held in trust for the plaintiff airline. The company had become insolvent and the airline sued its controlling director, Mr Tan, on the ground that he had knowingly assisted in the dissipation by BLT of the money. Lord Nicholls of Birkenhead said, at p 393:

> 'The defendant accepted that he knowingly assisted in that breach of trust. In other words, he caused or permitted his company to apply the money in a way he knew was not authorised by the trust of which the company was trustee. Set out in these bald terms, the defendant's conduct was dishonest. By the same token, and for good measure, BLT also acted dishonestly. The defendant

was the company, and his state of mind is to be imputed to the company.'

108 But the attribution to BLT of Mr Tan's dishonesty for the purposes of the airline's claim against, in effect, BLT and Mr Tan, could not be taken to bar misfeasance proceedings by the liquidator of BLT **(p. 168)** against Mr Tan or against any other officer of BLT who, in relation to the trust money, 'has … been guilty of any misfeasance or breach of any … other duty in relation to' BLT …

109 It is noteworthy that there appears to be no case in which the 'sole actor' exception to the *Hampshire Land Co* rule has been applied so as to bar an action brought by a company against an officer for breaches of duty that have caused, or contributed to, loss to the company as a result of the company engaging in illegal activities. I can easily accept that, for the purposes of an action against the company by an innocent third party, with no notice of any illegality or impropriety by the company in the conduct of its affairs, the state of mind of a 'sole actor' could and should be attributed to the company if it were relevant to the cause of action asserted against the company to do so. But it does not follow that that attribution should take place where the action is being brought by the company against an officer or manager who has been in breach of duty to the company. …

110 It appears that the liquidators of S & R know of no assets of Mr Stojevic that could become the fruits of successful proceedings against him for breach of duty. But suppose that were not so. There can surely be no doubt that the liquidators could issue a misfeasance summons against him under section 212(1)(c) of the Insolvency Act 1986. Could Mr Stojevic, on such a summons, contend that his dishonesty should be attributed to the company that, in breach of his fiduciary duties under the power of attorney, he had turned into his vehicle for fraud? … Mr Stojevic could not, in my opinion, reduce his liability for breach of duty to S & R by attributing to S & R his own dishonesty, praying in aid the 'sole actor' exception and the application of the *ex turpi causa* rule.

111 It is not clear to me why Moore Stephens, or any other officer of S & R whose breach of duty had contributed to the liabilities to which S & R is now subject, should be in any different position, so far as attribution to S & R of Mr Stojevic's dishonesty is concerned, to that of Mr Stojevic himself. Moore Stephens were not … directors or managers of the company's business. But they, too, as officers of the company [see IA 1986 s 212(1)(a)] could have been, and could still be, the recipients of a section 212 misfeasance summons. … No doubt the same *ex turpi causa* objection would have been taken but the nature of the claim, as one being brought for the benefit of S & R's creditors, would have been more openly apparent and not in the least a matter of objection.

112 So I return to what I regard as the determinative issue, short but difficult. Why should the dishonesty of Mr Stojevic be attributed to S & R for the purposes of an action by S & R against its auditors, officers of the company who, on the assumed facts, had committed breaches of contractual duty that had a causative role in producing the liabilities to which S & R is subject? There are, in my opinion, two reasons why that attribution should not be made: the first is a procedural reason, the second is substantive.

117 … Everything done by S & R at the direction of Mr Stojevic and in pursuance of his scheme of fraud must have been ultra vires his powers under the power of attorney. This feature could not enable S & R to resist the claims made by the defrauded third parties such as KB [a bank] but, in my opinion, establishes S & R as a victim of the fraudulent scheme. In causing S & R to pay away to third parties the money fraudulently extracted from KB and the other victims of the frauds Mr Stojevic was abusing his powers under the power of attorney. That abuse was an essential feature of Mr Stojevic's fraudulent scheme and, as it seems to me, S & R was a victim of that abuse. …

118 The emphasis placed by [the majority of their Lordships] on the assumed absolute beneficial ownership by Mr Stojevic of the S & R shareholding, coupled with his undoubted absolute managerial control, indicates, I suggest, that they are, in effect, lifting the corporate veil and treating S & R as if it were Mr Stojevic himself who was seeking to repel the *ex turpi causa* defence. But if the corporate veil cannot be lifted, and it cannot, in my opinion, if Mr Stojevic was not the absolute beneficial owner of the shares, the attribution of Mr Stojevic's dishonesty to S & R for the purpose of defeating an admitted breach of duty by S

& R's officers, a breach of duty that had caused S & R to incur liabilities that it would not otherwise have incurred, cannot, in my opinion, be justified either in principle or on authority. S & R is a legal persona in its own right …

(p. 169) LORD WALKER OF GESTINGTHORPE:

144 [After examining various precedents, he continued:] In all these cases there was a company which was the victim of a fraud or serious breach of duty, and the court held that it was not to be prejudiced by the guilty knowledge of an individual officer who could not be expected to disclose his own fault. (The fact that duties were owed to two different companies in the *Hampshire Land* [and other] cases is, I think, an irrelevant coincidence) …

146 Mr Brindle has relied on the *Hampshire Land* principle to insulate S & R, for the purposes of the *ex turpi causa* rule, from Mr Stojevic's fraudulent conduct. Mr Sumption, for Moore Stephens, has in the Court of Appeal and before the House deployed two lines of argument against that. The first is that the principle has no application in a case where the person or persons with ownership and control of the company are entirely complicit in the fraud, so that there is no single individual connected with the company who can be regarded as an innocent party deceived and prejudiced by the fraud. This is, in the terminology used in the United States, the 'sole actor' exception to the 'adverse interest' rule—which is itself an exception to the ordinary rules of imputation. In England the phrase 'one-man company' is sometimes used … The other line of argument is that the *Hampshire Land* principle does not apply to cases where the victim of the fraud is not the company itself, but a third party. This leads on to arguments as to whether the company in question, although not a primary victim, should be regarded as a secondary victim (and so within the principle). …

167 … In the case of a one-man company (in the sense indicated above) which has deliberately engaged in serious fraud, I would follow *Royal Brunei* **[7.43]** (and the strong line of United States and Canadian authority) in imputing awareness of the fraud to the company, applying what is referred to in the United States as the 'sole actor' exception to the 'adverse interest' principle.

168 In particular I would apply the 'sole actor' principle to a claim made against its former auditors by a company in liquidation, where the company was a one-man company engaged in fraud, and the auditors are accused of negligence in failing to call a halt to that fraud. Here I return to Mr Brindle's point … about the need to decide any question of attribution by reference to its context. Looking at the context, I cannot accept his submission that a claim against auditors is a context in which S & R should not be treated as primarily (or directly) liable for its fraud against [the banks], and so disabled by the *ex turpi causa* principle. Mr Sumption conceded, in line with the pleadings, that the auditors did owe a duty of care to S & R … On the assumption that the auditors did owe a duty of care to S & R, it was a duty owed to that company as a whole, not to individual shareholders, or potential shareholders, or current or prospective creditors, as this House decided in*Caparo Industries plc v Dickman* **[8.04]**. If the only human embodiment of the company already knew all about its fraudulent activities, there was realistically no protection that its auditors could give it. …

186 My Lords, after trying to analyse the intricacies of a complex and difficult case it is often helpful to stand back, as we say, and try to identify the essentials. Had Mr Stojevic acted alone in his fraud (for instance, had S & R been a completely fictitious company, never properly incorporated) it is perfectly clear that he would have had no cause of action against Moore Stephens because of (among other reasons) the *ex turpi causa* rule. That would have been the case even if the action had been taken by his trustee in bankruptcy acting solely for the benefit of the defrauded bank and other innocent creditors. … The *ex turpi causa* rule is distinct from the general principle that a claimant should not obtain a personal profit from his own wrong, although the two often overlap.

187 The same results would follow if Mr Stojevic had an individual partner in crime … Two highwaymen may be partners in crime but neither can sue the other for an account: *Everet v Williams* (1725), a case which was once thought to be apocryphal, but is verified by a note in (1893) 9 LQR 197 … [equally if the claim] had been brought, not by Everet himself but by the administrator of his insolvent estate, after Everet had

been hanged at Tyburn, even though the administrator might have been suing exclusively for the benefit of those whom the pair had robbed.

188 Why then does it make a difference that S & R, Mr Stojevic's partner in crime, was not an individual but a corporation? For present purposes there is an obvious parallel between an action by a company in insolvent liquidation, and an action by the trustee in bankruptcy of an individual, or the administrator of the estate of an individual who has died insolvent. In each case the action is **(p. 170)** being brought by or under the control of a fiduciary for the benefit of innocent creditors. But in each case the fiduciary can have no better cause of action than the insolvent company or individual, since the *ex turpi causa* rule is 'unforgiving and uncompromising'. I can see no reason why the corporate status of S & R should alter the analysis. Once it is accepted (first) that a company can have a guilty mind (*Tesco Supermarkets Ltd v Nattrass* **[3.28]**; *Royal Brunei Airlines Sdn Bhd v Tan* **[7.43]**) and (second) that S & R was directly (and not merely vicariously) liable for the frauds, then it seems to me to be in just the same position as one of the highwaymen.

189 My noble and learned friend, Lord Scott of Foscote, considers that the position is different because S & R was itself a victim. It had been turned, in his view, into a corporate automaton. … That view contradicts not only the Court of Appeal but also the judge. Langley J [the trial judge] observed [para 65(6)]:

> 'The primary victims of the fraud were KB and the other losers. The fraud undoubtedly exposed S & R to liabilities to KB and the other losers, which it could not meet once, as was intended, the moneys fraudulently obtained were paid away as they were to those responsible for the fraud. On the other hand S & R lost nothing to which it was ever entitled. S & R was in a real sense the perpetrator of the fraud on KB and the banks and the liability to which it was thereby exposed was not just the product of that fraud but the essence of it. In the particular circumstances of this case in my judgment it would be artificial not to fix S & R with the knowledge and wrongdoing of Mr Stojevic and also artificial to describe S & R even as a secondary victim of the fraud.'

That puts the point very clearly. Lord Scott's view seems to me to treat the most obvious and extreme situation of a company which has a guilty mind (a one-man company engaged in wholly fraudulent activities) as amounting to a situation in which the company has no mind at all. That view, with great respect, seems to me to be inconsistent with *Royal Brunei Airlines v Tan* …

LORD BROWN OF EATON-UNDER-HEYWOOD:

197 … As Mr Sumption put it, uncontentiously, at the beginning of his printed case:

> '[Mr Stojevic] was as completely identified with the company as it is possible for a human agent to be. He had sole control over the company's every act. He was the company's sole beneficial owner. There were no independent or innocent directors whom Mr Stojevic had to deceive to make the fraud happen. There were no innocent shareholders relying upon the auditors to monitor the management. There were no employees.'

198 How in these circumstances there is any room for the application of the *Hampshire Land* principle … I cannot for the life of me see. That principle, otherwise described as the adverse interest rule, operates as an exception to the ordinary rule of attribution, itself a general principle of agency, that ordinarily one imputes to the company (the principal) the knowledge of a director (the agent) on the basis that the agent may be presumed to have discharged his duty to disclose all material facts to his principal. The *Hampshire Land* exception recognises that in reality agents will not disclose to their principals the fact that they are committing fraud, least of all when they are defrauding the principals themselves, and that it would be contrary to common sense and justice for the law to presume otherwise. Indeed, the*Hampshire Land* principle may well go wider than this and extend also to breaches of duty by the agent short of fraud

… and to agents' frauds even if committed against others than their principals, and perhaps irrespective of whether the principal is to be regarded as 'a secondary victim' … For the purposes of the present appeal, however, it is quite unnecessary to explore, let alone decide, any of this.

199 In the present case Mr Stojevic and S & R were in effect one and the same person. It is absurd to describe Mr Stojevic as the agent and S & R as the principal for all the world as if, but for the *Hampshire Land* principle, the law would presume that Mr Stojevic had been disclosing to S & R his fraudulent conduct towards the Czech Bank. As Lord Reid said in *Tesco Supermarkets Ltd v Nattrass* **[3.28]**, 170:

> **(p. 171)** 'He is not acting as a servant, representative, agent or delegate. He is an embodiment of the company or, one could say, he hears and speaks through the persona of the company, within his appropriate sphere, and his mind is the mind of the company. If it is a guilty mind then that guilt is the guilt of the company.'

200 For this reason I find the concept of the 'sole actor' exception to the adverse interest exception (the *Hampshire Land* principle) a somewhat puzzling one. Why is it necessary to except from an exception a category of case which cannot logically fall into the exception in the first place? Assuming, however, that there is scope for such an exception to the *Hampshire Land* principle, then the need for it seems to me compelling …

201 It is on this basis and this basis alone—the one-man company or sole actor basis—that I would uphold the Court of Appeal's judgment that S & R is in no different or better position than Mr Stojevic himself to resist the *ex turpi causa* defence (and the liquidator of S & R in no better position than either of them).

LORD MANCE (dissenting):

206 … I consider that the key to a proper resolution of this appeal is to bear firmly in mind: (a) the separate legal identities of a company and its shareholders; (b) the common law and contractual duties which it is common ground that auditors owe and which included in this case an express undertaking to comply with auditing standard SAS 110 on fraud and error of the Auditing Practices Board; (c) the rights that a company has as a result as against those who, whether as officer or auditor, commit wrongs against it; (d) the distinction between on the one hand a company's claim for its own net losses, for which it is entirely consistent with*Caparo Industries plc v Dickman* **[8.04]** that it should be able to sue auditors whose negligence led to such losses, and on the other hand its creditors' losses, for which under *Caparo* its creditors cannot sue negligent auditors; (e) the basic company law principle that the interests and powers of shareholders yield to those of creditors in a company which is actually or potentially insolvent. I differ from the majority speeches in this case because they fail in my respectful opinion to take these points duly into account.

207 Within the majority speeches, although their reasoning differs, there can be found (i) an inversion of the decision in *Caparo*—whereby the denial to creditors in that case of recovery against auditors because the company would have its own claim is deployed to deny the company's claim against auditors because this would indirectly benefit the company's creditors; (ii) a suggestion, never pleaded or raised by the auditors, that the auditors' contractual engagements might be unenforceable *ab initio*; (iii) a suggestion that the company did not suffer any loss at all—a surprising proposition, when its assets were over years steadily abstracted from it leaving it with a large deficit out of which it was unable to meet its liabilities to the banks; (iv) a suggestion that a company might be unable to recover against auditors, if some or apparently even one of its shareholders were complicit in fraud committed by the company's directing mind and will causing the company to suffer loss—a suggestion which if good would have provided auditors with immunity in a large number of auditors' negligence claims. I will explain my disagreement with each of [these] points …

227 Though not essential to my reasoning, I also consider that the principle established in *In re Hampshire Land* Co **[3.31]**, *Belmont Finance* [1979] Ch 250 and*Attorney General's Reference (No 2 of 1982)* [1984] QB 624 points towards the same result. It prevents a company being treated as party to a fraud committed by

its officers ‘on’ or ‘against’ the company, at least in the context of claims by the company for redress for offences committed *against* the company …

228 Mr Sumption submits that the [*Hampshire Land*] principle has no present relevance for two reasons. The first is based on its original rationale: that, since an agent deceiving a company will not disclose his own fraud to the company, the company cannot be imputed with knowledge of or treated as party to the fraud. This rationale, Mr Sumption submits, postulates a company with an ‘innocent constituency’ (other officers and/or shareholders) to whom Mr Stojevic could have disclosed, but from whom he would and did actually conceal, his misdeeds. If the suggestion is that the *Hampshire Land* principle or the thinking behind it can only apply where a company alleges loss **(p. 172)** through being deceived, I see no reason why it should be so confined. Whether knowledge should be attributed to a company is irrelevant in contexts like the present, where S & R’s claim is not that there were others within the company who relied on misleading statements by Mr Stojevic, but rather that Mr Stojevic’s actions were in breach of his duties to S & R and that, had Moore Stephens detected them, no further breaches of duty would have been possible.

229 Neither in *Belmont Finance* nor in *Attorney General’s Reference (No 2 of 1982)* is there any suggestion that the application of the principle in *Hampshire Land*depends upon there being some innocent constituency within the company to whom knowledge could have been communicated. Moreover, *Attorney General’s Reference (No 2 of 1982)* … is direct authority to the contrary. The two defendants were charged with theft, consisting of the abstraction of the assets of companies, of which they were ‘the sole shareholders and directors’ and ‘the sole will and directing mind’. They contended that the companies were bound by and had consented to the abstractions precisely because they were its sole shareholders, directors and directing mind and will. The Court of Appeal acknowledged the rule of attribution attributing to a solvent company the unanimous decision of all its shareholders, but roundly rejected its application to circumstances where the sole shareholders, directors and directing minds were acting illegally or dishonestly in relation to the company. The court cited *Belmont Finance* as ‘directly contradict[ing] the basis of the defendants’ argument’. The defendants’ acts and knowledge were thus not to be attributed to the companies—although there was no other innocent constituency within the companies. [All page references omitted.] Another justification for this conclusion may be that the effect of the limitations recognised by Lord Hoffmann in*Meridian* **[3.29]** is that in such situations there *is* another innocent constituency with interests in S & R, since it is not open even to a directing mind owning all a company’s shares to run riot with the company’s assets and affairs in a way which renders or would render a company insolvent to the detriment of its creditors.

230 The second reason advanced by Mr Sumption is that, if the *Hampshire Land* principle could otherwise apply, the fraud here was committed on the banks, not on S & R. The Court of Appeal agreed with this submission. The company’s exposure when it was left ‘holding the baby’ was merely a ‘secondary exposure’ which was not enough to engage the principle …

235 Does it make any difference to the result if the company’s directing mind(s) also own all its shares? Here it is necessary to return to the common law rule of attribution to which Lord Hoffmann referred in *Meridian*, that the unanimous decision of all the shareholders in a solvent company about anything that the company has power to do under its memorandum of association counts as a decision of the company. Lord Hoffmann cited Dillon LJ’s statement in *Multinational Gas* **[7.39]**, 288G–H, that ‘so long as the company is solvent the shareholders are in substance the company’. In consequence, Kerr LJ said in *Attorney General’s Reference (No 2 of 1982)* [1984] QB 624, 640, ‘the decisions alleged to have been taken negligently or in breach of duty [in *Multinational Gas*] were the decisions of the company itself and—the transactions being intra vires the company’s memorandum—there was no basis for any claim by the liquidator.’

236 However, the limitations mentioned by Lord Hoffmann are important. The transactions must be within the company’s power under its memorandum of association; and it is only the unanimous decision of all the shareholders in a *solvent* company that can authorise or ratify an act that would otherwise constitute a breach of duty to the company, and make it the company’s. No argument was addressed to the House on the former limitation, which in the present context probably overlaps with the latter. Transactions entered

into by directors amounting in substance to no more than the fraudulent abstraction of increasingly large sums from an increasingly insolvent company with no other assets are unlikely to be within the scope of the company's powers; and the breach of duty involved in entering into such transactions cannot be answered by pointing to the directing mind's ownership of all the company's shares. This, as I have noted [earlier], is what was decided by the Court of Appeal in *Attorney General's Reference (No 2 of 1982)* [1984] QB 624, a decision which was clearly right. In summary, at latest once directors know that a company is or would be insolvent, a disposition of the company's assets in disregard of the general creditors of the insolvent company will be actionable by the company, whatever the shareholders may wish or approve: see also per **(p. 173)** Dillon LJ in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250, 252, distinguishing the situation in *Multinational Gas* as one where the company was 'amply solvent, and what the directors had done at the bidding of the shareholders had merely been to make a business decision in good faith, and act on that decision'; and also per Kerr LJ in *Attorney General's Reference (No 2 of 1982)* [1984] QB 624, 640D–641C distinguishing *Multinational Gas* [1983] Ch 258 as not 'concerned with allegations that the shareholders and directors had acted illegally or dishonestly in relation to the company'.

237 The current edition (2007) of *Palmer's Company Law Annotated Guide to the Companies Act 2006* states the position, at p 169:

> 'The scope of the common law duty requiring directors to consider the interests of creditors is more controversial. Cases support a variety of propositions, but the better accepted view is that a duty is owed by directors to the company (and not to the creditors themselves: *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187, 217, PC; *Yukong Line Ltd of Korea v Rendsburg Investments Corpn of Liberia (No 2)* [1998] 1 WLR 294 [Toulson J]), and this duty requires directors of insolvent or borderline insolvent companies to have regard to the interests of the company's creditors (*West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250, CA).'

238 I agree with this analysis. …

➢ Questions

1. In introducing his analysis, Lord Phillips suggested that, as a matter of common sense, S & R's claim could not succeed. First, S & R was seeking to put itself forward as the victim of fraud when it was, in fact, the perpetrator of the fraud. Second, MS were also the victims of S & R's fraud, and it does not seem just that S & R should be able to bring a claim in respect of the very conduct that S & R had set about inducing. Finally, looking at the realities, the claim is actually brought for the benefit of the banks defrauded by S & R on the ground that MS should have prevented S & R from perpetrating the frauds. If it would not be considered fair, just and reasonable for the banks to have a direct claim (see *Caparo* **[8.04]**), then it would not seem fair, just and reasonable that they should achieve the same result through a claim brought by the company's liquidators for their benefit. These reasons may all accord with lay intuition on the matter, but do they each effectively deny the separate legal personality of the company? How should 'separate legal personality' be conceived of, meaningfully, in one man companies?

2. What differentiates the analyses offered by each of their Lordships? What role does each accord to: (i) the nature of the auditors' liability; (ii) the *ex turpi causa*principle; and the *Hampshire Land* principle? What conclusion would each have reached if S & R had been solvent? Or if S & R had had innocent shareholders?

3. Lord Phillips suggests 'that the real issue is not whether the fraud should be attributed to the company but whether *ex turpi causa* should defeat the company's claim for breach of the auditor's duty. That in turn depends, or may depend, critically on whether the scope of the auditor's duty extends to protecting those for whose benefit the claim is brought …'. Lord Phillips was not alone; all their Lordships grappled with the nature of the duty owed by auditors. Why should this be relevant?

4. After *Stone & Rolls*, how should the *Hampshire Land* principle be described? Is it an autonomous rule of attribution (ie it explains when an agent's acts or knowledge will count as the acts or knowledge of the company)? Or is it a defence, or a rule of estoppel, available to the company only in the context of litigation (either direct or indirect) between the company and its directors or other agents? If it is the latter, the consequence is that in *those* circumstances, but only then, the company will not be taken to have done the act itself, or approved it, or **(p. 174)** known of it, or ratified it, *so as to disentitle the company* from suing its defaulting officer or agent. This is a limited intervention. It would mean that, so far as third parties are concerned, the agent's acts may well count as those of the company, and expose the company to liability—indeed, recovery of the loss resulting from that exposure is usually precisely why the company seeks to sue its defaulting agent.

5. If fraudulent directors controlled a widely held company (ie one with a number of relatively independent shareholders), then the unanimous view in *Stone & Rolls*appears to be that the fraud would still be the company's fraud (so the banks could sue the company), but that the *ex turpi causa* principle would not apply to deny the company a claim against its auditors. Does this make sense, since in both cases it is equally true that at law the company is a separate person and in practice the shareholders themselves would be unlikely to recover anything given the insolvency? Does this also mean that the key issue in applying the *ex turpi causa* principle is not simply whether the *company* itself was fraudulent, but something more subtle (eg whether the court is assisting the wrongdoer to *benefit* from its wrong)? Has the line been blurred even further by the Chancellor's decision in *Bilta (UK) Ltd (In Liquidation) v Nazir* [2012] EWHC 2163 (Ch), in which a defence based on *Stone & Rolls*was refused on the ground that the duties owed by the directors in question, at the verge of the company's insolvency, 'encompassed persons or interests other than the fraudsters in corporate form'? Does the company cease to be a 'one man' company simply because the directors of a company owe a duty to consider the interests of its creditors in dire circumstances?

6. Could the courts have reached the same result in *Stone & Rolls* more simply? For example, suppose the court had ignored the *Hampshire Land* principle and the *ex turpi causa* rule, and allowed the company to sue its auditors for breach of duty. Even assuming the auditors had been negligent in failing to detect the fraud, could the auditors have argued that, in a one man company, their failure to report the frauds to the company had made no difference to the course of action pursued by the company, and therefore there was no loss for which they were liable? Even if this analysis *were* appropriate as between two contracting parties (or two tort litigants), could it ever prevail in a *Stone & Rolls* context, given that CA 2006 clearly indicates a public benefit role for auditors, so that external reporting may have effected an early cessation of the frauds?

7. Does this public benefit role of auditors suggest that the outcome favoured by the minority is preferable as a matter of policy?

8. Does the decision fail to distinguish between how the company *acts* (or thinks or knows) and what the company *is* ?

Where a company is 'personally' liable, in the sense that its liability is not vicarious, the acts of the company will be considered 'personal' such that the maxim* ex turpi causa *will apply, thus precluding the company from recovering losses from the very employees and directors whose conduct created the company's liability.

[3.33] Safeway Stores Ltd v Twigger [2010] EWCA Civ 1472 (Court of Appeal)

LONGMORE LJ:

19 The difficulty and novelty of the present case is that the claimants are a corporation and can only act through their human agents. If it is those human agents who have acted intentionally or negligently and have thus caused the corporation to become liable by way of penalty to the OFT, does the maxim apply to preclude recovery of that penalty and its consequences from the very **(p. 175)** employees and directors whose conduct has created the corporation's liability? The judge has held that it arguably does not because

it has not been shown (at this stage of the proceedings at any rate) that any of the defendants was the 'directing mind or will' of any of the claimant companies; he thought that unless that could be shown it was impossible to say that the claimant companies were 'personally' at fault, and the maxim only applies where the claimant was 'personally' at fault, as accepted by Mr Jonathan Sumption QC in argument in *Stone & Rolls Ltd v Moore Stephens* and confirmed by the House of Lords in that case, at **[3.32]** paras 8 and 27–28.

20 At this stage it is important to recognise that the claimants' liability is not a vicarious one. They are not liable for the illegal acts of their agents or employees because s 36 1998 Act only imposes liability on an undertaking which is a party to an agreement which infringes the prohibition in Chapter 1 of the Act, and that liability can only be imposed if the infringement has been committed intentionally or negligently by the undertaking. The liability to pay the penalty is thus a liability of the undertaking where it (the undertaking) has intentionally or negligently committed the infringement. Mr Sumption submits in this case that that liability is therefore a 'personal' liability of the undertaking.

21 Mr Robert Anderson QC, for the claimants, submits that the companies could only be personally at fault if the infringement was committed or authorised by the board of directors acting as such, or by the shareholders in general meeting, unless there was some special rule of attribution applicable in the circumstances of the case. He relied for this purpose on the decision of the Privy Council in *Meridian Global Funds Management Asia Ltd v Securities Commission* **[3.29]** …

22 Mr Anderson submitted that there was no need to have regard to any 'special rule of attribution' in this case because the ex turpi maxim could not apply unless the claimants were personally at fault, and in no way could they be said to be personally at fault in this case.

23 This submission misunderstands or misapplies the use of the word 'personally' as applied in the requirement for the claimant to be 'personally' at fault. No one is liable for the penalty imposed by the 1998 Act except the relevant undertaking. The liability is therefore personal to the undertaking. If there is a liability it cannot be imposed on any person other than the undertaking, and the undertaking is personally liable for the infringement. If a penalty is imposed it will only be because the undertaking itself has intentionally or negligently committed the infringement. In those circumstances it is the undertaking which is personally at fault (there can be no one else who is), and once the maxim is engaged the undertaking cannot say that it was not personally at fault in order to defeat the application of the maxim. The whole hypothesis of the undertaking's liability is that it is personally at fault.

24 The judge expressed his views in the following way [2010] Bus LR 974, para 62:

> 'Attractively though these submissions on behalf of the defendants were put, I cannot accept them. It is true that, as between the claimants and the OFT, the issue of attribution did not arise since the relevant wrongdoing was inevitably that of the claimants as the "undertakings". It would have been of no avail for the claimants in their dealings with the OFT to say that it was the defendants who had carried out the anti-competitive acts and practices, since the defendants were directors and employees acting in the course of their employment. However, contrary to the defendants' submissions, the question whether, in consequence, the *ex turpi causa* rule applies to preclude a claim over against the defendants is simply not addressed by the Companies Act 1998, which is not concerned with relations between the undertaking and its employees. It seems to me that the answer to that question depends upon the correct analysis of the liability which the claimants are under.'

The judge then concluded, at para 68, that the claimants' liability was, arguably, not a personal liability at all and that the determination of that question depended on whether it could be said that each of the defendants was 'the "directing mind or will" … of the claimant companies' which could not be decided on an application for summary judgment.

25 The judge's approach would of course be correct if the question whether the claimant companies were

'personally' liable depended on proof that the defendants were their 'directing mind and will' (the phrase used by Viscount Haldane LC in *Lennards Carrying Co Ltd v Asiatic Petroleum Co* **(p. 176)** *Ltd* [1915] AC 705, 713–714). But in my judgment it does not so depend because it was sufficient for the OFT to show that the companies intentionally or negligently infringed the provisions of the 1998 Act; the companies have accepted that they did so infringe the 1998 Act and the question whether the defendants were the 'directing mind and will' of the companies does not come into the matter.

26 Mr Anderson further submits that the word 'personal' in the requirement for the claimant to be 'personally' at fault is used in a different sense from that in which it is used when one says that a corporation which cannot be vicariously liable is 'personally' liable. But it is difficult to see why that should be so. If indeed it were the law that the *ex turpi* maxim could only be used against a company if the act was specifically authorised by the whole board of directors (or the shareholders in general meeting) there would be little scope for the maxim to be used at all in a corporate context. That would not be a desirable legal development. To the extent that it might be suggested that the maxim could be used in addition against a company when it was an employee who was 'the directing mind or will' who intentionally or negligently committed the act of infringement, that would involve a potentially difficult and fact-sensitive inquiry which would be inappropriate for a maxim that is intended to be both comprehensible and readily applicable. It is more in accordance with principle to say that if the liability of the company is personal (rather than merely vicarious), then there is no impediment to the application of the maxim save (perhaps) in cases of strict liability where there has been no intention or negligence on the part of any person which is not something that needs decision now.

27 The judge appears to have accepted this part of Mr Anderson's argument because he says, in paras 74 and 75, that the claimant companies were liable to pay penalties not by virtue of any special rule of attribution in the *Meridian* sense but by virtue of the general law of agency. But to talk of liability for the acts of one's agents is to talk of vicarious liability, and the company's liability is not vicarious for the simple reason that the 1998 Act does not impose any liability of any kind on the directors or employees of an undertaking for which the companies can be vicariously responsible. The liability is a 'personal' one and that is enough to make the acts of the company 'personal' for the purpose of the application of the maxim.

Litigation: procedural issues

Conduct of litigation

Blackstone ('Limits to the idea of a company as a "person"?', p 77) quoted Sir Edward Coke as authority for the view that a company must always appear in court by attorney, 'for it cannot appear in person, being invisible, and existing only in intendment and consideration of the law'. The courts have for many centuries strenuously insisted on this rule, both in civil and in criminal cases, and it has only been by statute that inroads have been made into it —and then mainly in relation to lower courts such as the magistrates' courts. So we have the paradox that the law is happy to identify a company with the individual who is its 'directing mind and will' for the purpose of making it criminally liable, while at the same time it will refuse to allow the company to appear before it in the person of the same individual. This remains the basic rule: in*RH Tomlinssons (Trowbridge) Ltd v Secretary of State for the Environment* [1999] 2 BCLC 760, CA, it was solemnly affirmed by the Court of Appeal. However, the Civil Procedure Rules, which came into effect on 26 April 1999, allow a company (with the leave of the court) to appear by an *employee* and, by implication, to appear 'in person' in other ways, so that the rule has now been superseded for civil cases in the county courts and the High Court.

(p. 177) Service of documents

CA 2006 s 1139: Service of documents on company

A document may be served on a company registered under this Act by leaving it at, or sending it by post to, the company's registered office.