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CASE COMMENTARY

IS IT TIME TO KILL OFF *HAMPSHIRE LAND?* A REVIEW OF THE CASES ON THE ADVERSE INTEREST PRINCIPLE

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RULES OF ATTRIBUTION

In the early development of English Company Law it was doubted whether a company could be deemed to have the necessary "malice or motive" for most criminal and many tortious liabilities.[1] This view was rejected by the Privy Council in *Citizens' Life Assurance Co Ltd v Brown*,[2] which led to the concept of a company having attributed to it personally (as against vicariously) the thoughts and actions of its "directing mind and will". This was famously explained in a further House of Lords decision, *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd.*[3]

In the cases that followed, it became very unclear exactly who might be held to be the "directing mind and will" of a company, beyond any controlling directors. In *Tesco Supermarkets Ltd v Nattrass*, Lord Reid said:

> "Normally the board of directors, the managing director and perhaps other superior officers of a company carry out the functions of management and speak and act as the company. Their subordinates do not. They carry out orders from above and it can make no difference that they are given some measure of discretion. But the board of directors may delegate some part of their functions of management giving to their delegate full discretion to act independently of instructions from them. I see no difficulty in holding that they have thereby put such a delegate in their place, so that within the scope of the delegation he can act as the company." [4]

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[1] *Abrath v North Eastern Ply Co* (1886) App Cas 247 (HL) 271 (Lord Bramwell).

[2] [1904] AC 423 (PC).

[3] [1915] AC 705 (HL) 713 (Viscount Haldane).

[4] [1972] AC 154 (HL) 171.

On the facts of the case, however, the actions of the store manager were held not to be those of the company and so Tesco was able to claim the benefit of a statutory defence that the local mispricing of goods was the act of another under section 24(1) of the Trade Descriptions Act 1968.

In the Privy Council decision in *Meridian Global Funds Management Asia Ltd v Securities Commission*,[5] Lord Hoffmann reviewed the existing cases again. He felt that the terminology of the "directing mind and will" could be misleading and the explanation as to which individual's thoughts and actions were or were not to be attributed to the company lay more with interpreting the purpose of the law being applied:

> "The company's primary rules of attribution together with the general principles of agency, vicarious liability and so forth are usually sufficient to enable one to determine its rights and obligations. In exceptional cases, however, they will not provide an answer. This will be the case when a rule of law, either expressly or by implication, excludes attribution on the basis of the general principles of agency or vicarious liability… This is generally true of rules of the criminal law, which ordinarily impose liability only for the actus reus and mens rea of the defendant himself. How is such a rule to be applied to a company?
>
> One possibility is that the court may come to the conclusion that the rule was not intended to apply to companies at all; for example, a law which created an offence for which the only penalty was community service. Another possibility is that the court might interpret the law as meaning that it could apply to a company only on the basis of its primary rules of attribution, ie if the act giving rise to liability was specifically authorised by a resolution of the board or an unanimous agreement of the shareholders. But there will be many cases in which neither of these solutions is satisfactory; in which the court considers that the law was intended to apply to companies and that, although it excludes ordinary vicarious liability, insistence on the primary rules of attribution would in practice defeat that intention. In such a case, the court must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was *for this purpose* intended to count as the act etc of the company? One finds the answer to this question by applying the usual canons of interpretation, taking

[5] [1995] 2 AC 500 (PC).

> into account the language of the rule (if it is a statute) and its content and policy."[6]

Applying this approach, the Lord Hoffmann held that the failure of the investment manager of the Company was to be attributed to the Company as its failure to declare a shareholding as required by section 20 of the New Zealand Securities Amendment Act 1988.

Whatever the exact basis for these "special rules of attribution", the personal as against vicarious nature of the company's liability does mean that the company can in effect be deemed to be a co-conspirator with a director or other individual whose improper thoughts and/or actions have been attributed to it. This raises a difficult issue with which the courts have struggled for more than a century. It is clear that a company, and behind it, its shareholders and creditors, can be as much a victim as a perpetrator of a fraud or other wrong committed by its directors and/or other "directing mind and will". So, in what circumstances should the courts recognise this and not attribute the fraud or other wrong to the company?

HAMPSHIRE LAND

The complex history of cases dealing with this issue starts with two cases which were not stated to be based on the attribution or non-attribution of the thoughts and actions of a "directing mind and will" at all.

In *Re Hampshire Land Co*[7] the articles of Hampshire Land (the Company) restricted the ability of the Company to borrow unless authorised by its shareholders in general meeting. At a shareholders' meeting for which insufficient notice (both as to time and content) had been given, the shareholders purported to authorise the Company to borrow £30,000 from the Portsea Island Building Society (the Society).

Mr Wills was the Company Secretary of both the Company and the Society and knew that the notice for the shareholders' meeting of the Company was not valid. At that time, third parties (like the Society) dealing with a company were deemed to have constructive knowledge of any restrictions in the company's articles filed at Companies House; but if there were procedures to overcome such restrictions, the rule in *Royal British Bank v Turquand*[8] allowed the third party to presume that the procedures had been followed. The problem for the Society was that if the knowledge of its Company Secretary was attributed to it, that would defeat the presumption

[6] Ibid 507.
[7] [1896] 2 Ch 743 (Ch).
[8] (1856) 6 El & Bl 327 (Exch).

and the Society would be prevented from proving for its debt in the liquidation of the Company.

Justice Vaughan Williams did not accept that knowledge of a common officer had to be attributed to both his principals[9] and on the particular facts in *Hampshire Land* commented:

> "… if Wills had been guilty of a fraud, the personal knowledge of Wills of the fraud that had [been] committed upon the company would not have been knowledge of the society of the facts constituting that fraud; because common sense at once leads one to the conclusion that it would be impossible to infer that the duty, either of giving or receiving notice, will be fulfilled where the common agent is himself guilty of fraud. It seems to me that if you assume here that Mr Wills was guilty of irregularity – a breach of duty in respect of these transactions – the same inference is to be drawn as if he had been guilty of fraud."[10]

The problem with this rationale is that it is potentially incredibly wide. Virtually all improper thoughts and actions to be attributed to a company will have involved an agent in at least a breach of a duty of loyalty in not passing on his knowledge. Of course, *Hampshire Land* was only a first instance judgment and pre-dated *Lennards*, but Vaughan William's rationale was taken up by the House of Lords in the later case of *JC Houghton & Co v Nothard, Lowe & Wills.*[11]

There were two rival fruit trading companies, George Wills & Sons Ltd (Wills) and Nothard & Lowe Fruit & Preserving Co (Preserving). The companies agreed to combine their businesses under a new company, Nothard, Lowe & Wills (New Co). However, certain types of business continued to be reserved to Preserving. Maurice and George Lowe were directors of Preserving and New Co and Walker and Brand were directors of Wills and New Co.

The Lowes negotiated a written brokerage agreement with the appellant, JC Houghton & Co (the Broker), whereby in return for an exclusive agency, the Broker advanced £20,000 to Preserving. The Broker was then entitled to retain and apply 70% of the net proceeds of sale of Preserving's goods to repay the £20,000. Preserving, the Lowes and another also undertook in the agreement, that the Broker "shall be entitled to retain and apply in or towards repayment of the said advances, [70%] of the net proceeds of the sale of

[9] Citing *Re Marseilles Extension Railway Company, Ex p Credit Foncier and Mobilier of England* (1871-72) LR 7 Ch 161 (CA).
[10] *Hampshire Land* (n 7) 749.
[11] [1928] AC 1 (HL).

goods sold by [the Broker] on behalf of or as agents for [New Co].” New Co was found not to be a party to this agreement.

As directors of New Co, Walker and Brand knew nothing of the advances which were applied solely to the benefit of Preserving, nor of the apparent agreement that 70% of the net proceeds of the sale of New Co’s goods were to be applied to repaying the advances. The Broker’s claim was that the Lowes’ knowledge of the agreement must be attributed to New Co which would then be estopped by conduct amounting to acquiescence from denying the advances and retention arrangements. Viscount Dunedin, giving the leading judgment, said:

> “The knowledge of the company can only be the knowledge of persons who are entitled to represent the company. It may be assumed that the knowledge of directors is in ordinary circumstances the knowledge of the company. The knowledge of a mere official like the secretary would only be the knowledge of the company if the thing of which knowledge is predicated was a thing within the ordinary domain of the secretary’s duties. But what if the knowledge of the director is the knowledge of a director who is himself particeps criminis, that is, if the knowledge of an infringement of the right of the company is only brought home to the man who himself was the artificer of such infringement? Common sense suggests the answer, but authority is not wanting.”[12]

Viscount Dunedin then cited as precedents *Hampshire Land* and an earlier case *Lacey v Hill*[13] to hold that the Lowes’ knowledge should not be attributed and so New Co had not knowingly acquiesced to the advances and retention arrangements.

What is the common but perhaps unusual factor in these two cases was that it only required the normal attribution of an agent’s *knowledge* to his principal[14] to have led to the company’s civil liability to a third party. Mere knowledge would have defeated the protection of the rule in *Turquand* in *Hampshire Land* and created an estoppel in *JC Houghton*. Limiting English law’s rather easy attribution of an agent’s knowledge to his principal in this way may seem acceptable. However, the refusal to attribute knowledge using the *Hampshire Land* rationale, has been applied in other circumstances.

[12] Ibid 14.
[13] (1876) 4 Ch D 537 (CA).
[14] As against the personal attribution of dishonest, intentional or reckless thoughts and actions.

TOWARDS THE PRIMARY VICTIM PRINCIPLE

In *Belmont Finance Corp Ltd v Williams Furniture Ltd*[15] the Company sued two of its directors because they had caused the company *inter alia* to acquire shares in another company at a grossly inflated price. At first instance, the Company lost on the argument that the wrongs of the two directors were attributed to the company since the transactions had been approved at a full board meeting. However, that was overturned on appeal. As Lord Justice Buckley said:

> "… [the plaintiff] was a victim of the conspiracy. I think it would be irrational to treat the directors, who were allegedly parties to the conspiracy, notionally as having transmitted this knowledge to the [plaintiff]; and indeed it is a well-recognised exception from the general rule that a principal is affected by notice received by his agent that, if the agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal."[16]

Although not cited in *Belmont*, this view is clearly based on *Hampshire Land.* This victim concept was taken up and extended in *Attorney-General's Reference (No 2 of 1982).*[17] Controlling director-shareholders of the Company were charged with stealing from the Company. It was argued that as the knowledge and dishonest intent of such controllers had to have been attributed to the Company, the Company must logically have consented to the appropriations. This was rejected by the Court of Appeal. Lord Justice Kerr cited the passage from *Belmont* above and said:

> "So far as the authorities in the realm of the civil law are concerned, this decision directly contradicts the basis of the defendants' argument in the present case. There can be no reason, in our view, why the position in the criminal law should be any different."[18]

A further extension of the victim concept was attempted in first *McNicholas Construction Co Ltd v Customs and Excise Commissioners*[19] and

[15] [1979] Ch 250 (CA).
[16] Ibid 261.
[17] [1984] QB 624 (CA).
[18] Ibid 641.
[19] [2000] STC 553 (QB).

then *Morris v Bank of India.*[20] In *McNicholas* site managers of the Company created paperwork indicating payments to bogus sub-contractors in order to recover VAT that had never been paid. This apparently made the company liable to pay compensation to the VAT man and the Company argued that the fraudulent behaviour of its site managers should not be attributed to the Company as, although the fraud was primarily aimed at the VAT man, this risk to the Company made it a secondary victim. As Justice Dyson said:

> "The *Hampshire Land* principle or exception is founded in common sense and justice. It is obvious good sense and justice that the act of an employee should not be attributed to the employer company if, in truth, the act is directed at, and harmful to, the interests of the company. In the present case, the fraud was not aimed at [the company]. It was not intended by the participants in the fraud that the interests of [the company] should be harmed by their conduct. In judging whether the fraud was in fact harmful to the interests of [the company], one should not be too ready to find such harm."[21]

The same argument was adopted by the Court of Appeal in *Morris v Bank of India*. The London manager of the Bank of India, Mr Samant, had involved the Bank in a scheme that had as its aim fraudulently to deprive the creditors of another bank, Bank of Credit and Commerce International (BCCI), of their rights. This involvement in the scheme exposed the Bank of India to claims from BCCI of fraudulent trading under section 213 of the Insolvency Act 1986. In rejecting the application of the *Re Hampshire Land* principle, Lord Justice Mummery said:

> "Clearly there are some circumstances in which an individual's knowledge of fraud cannot and should not be attributed to a company. The classic case is where the company is itself the target of an agent's or employee's dishonesty. In general, it would not be sensible or realistic to attribute knowledge to the company concerned, if the attribution had the effect of defeating the right of the company to recover from [the] dishonest agent or employee or from a third party. [Counsel] argued that there should be no attribution of knowledge as this was a case in which [the Bank of India] was the 'secondary victim' of Mr Samant. His actions were harmful to the interests of [the Bank of India], as he had exposed it to the risk of potential liability for fraudulent trading. We have no hesitation in rejecting [this]

[20] Aka *Re Bank of Credit and Commercial International SA (No 15)* [2005] EWCA Civ 693; [2005] 2 BCLC 328.
[21] *McNicholas* (n 19) [55], [56].

> submission. If it were correct, it would never be possible to attribute the knowledge of the individual to a company under section 213."[22]

This last point highlighted the dangerously wide potential of the *Hampshire Land* rational and the development of the primary victim principle was clearly an attempt to restrict its application. Of course, it is hard to classify the Society in *Hampshire Land* as a primary victim, but the non-attribution of knowledge of a company's constitution to a bona fide third parties is now dealt with by section 40 of the Companies Act 2006.[23] The Society would almost certainly be treated as bona fide now because section 40(2)(b) specifically says:

> "A person dealing with a company...
> (iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution."

As for *JC Houghton, a*lthough not characterised in this way by the House of Lords, the Lowe brothers' attempts to divert New Co's resources to pay Preserving's debts did make New Co look like a primary victim.

So, to this point, the case history suggested that, at least in cases requiring more than the attribution of knowledge under general agency principles, the courts would only attribute dishonesty, intent etc where special rules of attribution applied (usually involving a "directing mind and will"). However, such attribution would not be made where the company was the "primary victim".

This whole area has now been reconsidered by the Court of Appeal in *Bilta (UK) Ltd v Nazir*.[24]

REJECTING *HAMPSHIRE LAND*

In *Bilta*, Mr Nazir and Mr Chopra were the Company's only directors and Mr Chopra the sole shareholder. The company bought and sold European Emissions Trading Scheme Allowances (EUAs) which at the time were VATable. However, the two directors arranged transactions with other corporate defendants apparently to ensure that the Company never had sufficient funds to pay the VAT as it became due (known as a carousel fraud).

[22] *Morris* (n 20) [114].
[23] Section 40 has been held to cover procedural matters formerly subject to the rule in *Turquand* (n 8), see *Smith v Henniker-Major and Co* [2002] EWCA Civ 762; [2003] Ch 182.
[24] [2013] EWCA Civ 968; [2014] Ch 52.

So from the very start of trading, the Company was insolvent and now its liquidator was seeking damages and equitable compensation from the directors and these other corporate defendants, allegedly all involved in this conspiracy. In this hearing in front of the Court of Appeal, the corporate defendants were seeking to strike out the action against them on the grounds that the only victim of the alleged conspiracy was the VAT man and the Company was a perpetrator of the fraud because the conduct of the directors and sole shareholder had to be attributed to it personally.

This argument was rejected at 1st instance and by the Court of Appeal. In the leading appeal judgment, Lord Justice Patten cast some doubts on both the *Hampshire Land* and primary victim rationales. He pointed out that:

> "[*Re Hampshire Land Co*] was concerned only with the imputation of knowledge which was relevant to Portsea's ability to enforce a contract that was unauthorised by Hampshire Land. The judge treated it as a question of whether the knowledge of an agent should be imputed to his principal and it was not therefore necessary for him to consider any wider issues of attribution relevant to unlawful conduct. In particular, the rationale based on the inherent unlikelihood of the director disclosing his own fraud to the object of his deceit might be thought to apply even where the intended victim was not the company, of which he was a director or officer but was a third party. Yet this was not sufficient to prevent attribution in [*El Ajou's* case] and the other liability cases I mentioned earlier."[25]

These "liability cases" were *El Ajou v Dollar Land Holdings plc,*[26] *Royal Brunei Airlines Sdn Bhd v Tan,*[27] *McNicholas Construction Co Ltd v Customs and Excise Comrs*[28] and *Morris v Bank of India.*[29] As Lord Justice Patten pointed out, in these cases:

> "… reliance on the consequences to the company of attributing to it the conduct of its managers or directors is not enough to prevent attribution because… it would prevent liability ever being imposed. As between the company and the defrauded third party, the former is not to be treated as a victim of the wrongdoing on which the third party sues but one of the perpetrators."[30]

[25] Ibid [41].
[26] [1994] 2 All ER 685 (CA).
[27] [1995] 2 AC 378 (PC).
[28] *McNicholas* (n 19).
[29] *Morris* (n 20).
[30] *Bilta* (n 24) [34].

On the other hand, he thought that non-attribution could arise in secondary damages cases.

> "But it does not follow… that secondary damage of the kind relied on unsuccessfully in the liability cases will not be sufficient to prevent attribution when it forms the subject matter of the action by the company against those whose breach of duty has caused it. In that context the damage is not secondary but primary and the company is the direct victim of the breach of duty relied on. It ought therefore not to matter whether the conspiracy alleged in these proceedings had as its object a VAT fraud on HMRC or is limited to depriving Bilta of the proceeds of sale from the EUAs."[31]

So Lord Justice Patten took the view that in civil cases, the wrongdoings of a company's agents (at least those who could be viewed as the "directing mind and will") should be attributed to the company where the issue was the company's liability to third parties, but not where the issue was the breach of duty of the agent to the company. Likewise presumably in criminal cases, attribution to the company would arise where it served the purpose of the statute in protecting third parties and the public,[32] but not where it would prevent the purpose of protecting the company.[33]

To get to the position of rejecting both the *Hampshire Land* and primary victim rationales, Lord Justice Patten was forced to re-write some the rationales given for previously decided cases. What, as he himself admitted, could still stand in the way of this approach was the 3-to-2 majority decision of the House of Lords in *Stone & Rolls Ltd v Moore Stephens.*[34]

STONE & ROLLS

As I have written elsewhere,[35] this penultimate decision of the Appellate Committee of the House of Lords[36] was not perhaps its finest hour. In *Stone & Rolls* Mr Stojevic acquired the Company to use as a vehicle for a Ponzi scheme based on obtaining ever larger letters of credit from banks against

[31] Ibid [45].
[32] *Meridian* (n 5).
[33] *Attorney-General's Reference* (n 17).
[34] [2009] UKHL 39; [2009] 1 AC 1391.
[35] Alistair Alcock, 'Auditors' Liability and Stone & Rolls Ltd v Moore Stephens' in *Gore-Browne on Companies Special Release* (Jordans 2011) 6.
[36] In 2009, the judicial functions of the House of Lords were transferred to a new Supreme Court.

bogus equipment purchases. When eventually the Company defaulted, a Czech bank found itself owed nearly $200 million. The moneys paid to the Company and indeed to Mr Stojevic had disappeared. So the Company's liquidator proceeded to sue the auditors of the Company, Moore Stephens, for failing to detect and thereby prevent the escalation of the fraud. In this hearing, the auditors had applied to strike out the action on the grounds that the Company was barred from suing by the *ex turpi causa* principle. The auditors claimed that the Company was itself a perpetrator of the fraud with Mr Stojevic since, as the "directing mind and will" of the Company, indeed probably its only shareholder, his fraudulent intent and actions had to be attributed to the Company.

In *Bilta*, Lord Justice Patten's analysis of the decision in *Stone & Rolls* was that two of the majority, Lords Walker and Brown, held that *Hampshire Land* (referred in *Stone & Rolls* as the "adverse interest" principle or rule) would have applied had not ownership and control vested entirely with the fraudster, ie a "sole actor".[37] Also, unfortunately for Lord Justice Patten's analysis of the old cases, Lord Walker (with whom Lord Brown basically concurred) went on to say of the adverse interest principle:

> "I can see no reason why the principle should be limited to claims. It is… a general principle of agency which can apply to any issue as to a company's notice, knowledge or complicity, whether that issue arises as a matter of claim or defence."[38]

Lord Justice Patten dismissed this as "true but the contexts in which the point arises are very different."[39]

On the sole actor exception to the adverse interest principle, Lord Walker looked to the US decision in *Mediators Inc v Manney*, *Re The Mediators Inc.*[40] He explained this and the argument that the Company was only a secondary victim and so not entitled to the adverse interest principle thus:

> "It is necessary to keep well in mind why the law makes an exception (the adverse interest rule) for a company which is a primary victim (like the Belmont company, which was manipulated into buying Maximum at a gross overvaluation). The company is not fixed with its directors' fraudulent intentions because that would be unjust to its innocent participators (honest directors who were deceived, and

[37] *Bilta* (n 24). The 'adverse interest' and 'sole actor' terminology comes from US cases.
[38] *Stone & Rolls* (n 34) [145].
[39] *Bilta* (n 24) [59].
[40] (1997) 105 F 3d 822, 827.

> shareholders who were cheated); the guilty are presumed not to pass on their guilty knowledge to the innocent. But if the company is itself primarily (or directly) liable because of the 'sole actor' rule, there is ex hypothesi no innocent participator, and no one who does not already share (or must by his reckless indifference be taken as sharing) the guilty knowledge."[41]

However, Lord Justice Patten took the view that the third member of the majority in *Stone & Rolls*, Lord Phillips, came to his conclusion by a very different route:

> "Lord Phillips of Worth Matravers considered that the answer to the question whether the *ex turpi causa* rule applied to the claim was not to be found in the application of the *Hampshire Land* principle but by looking behind the company at the persons whose interests the duty of the auditors was intended to protect. Since this was owed to the shareholders of the company and not to its creditors, there was no justification for disapplying the *ex turpi causa* rule."[42]

As Lord Phillips put it himself:

> "I have reached the conclusion that all whose interests formed the subject of any duty … owed by Moore Stephens to S&R, namely the company's sole will and mind and beneficial owner Mr Stojevic, were party to the illegal conduct that forms the basis of the company's claim. In these circumstances I join with Lord Walker and Lord Brown in concluding that *ex turpi causa* provides a defence."[43]

Since only two of the majority relied upon any argument involving *Hampshire Land*, Lord Justice Patten also considered the two dissenting judgments. Lord Scott based his judgment primarily on there being no public policy purpose in applying the *ex turpi causa* rule at all.[44] As for the sole actor exception:

> "It is noteworthy that there appears to be no case in which the 'sole actor' exception to the *Hampshire Land* … 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

[41] *Stone & Rolls* (n 34) [173].
[42] *Bilta* (n 24) [54].
[43] *Stone & Rolls* (n 34) [86].
[44] Ibid [120].

> 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… 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… 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."[45]

Lord Mance attacked the argument that the Company was a secondary victim and so could not claim the benefit of *Hampshire Land*, an argument that had persuaded the Court of Appeal to uphold the defence of *ex turpi causa.*

> "In distinguishing between the primary and secondary victims, the Court of Appeal in the present case was, however, influenced by reasoning in *McNicholas.*.. and [*Morris v Bank of India*]… Both those cases were… concerned with claims *against* the company by injured third parties, rather than claims by the company against others in breach of duty to it. So it is not clear why the *Hampshire Land* issue arose at all, and in my view the statements in them are of no assistance in resolving any issue of attribution in the present context."[46]

He also disliked importing the "sole actor" rule from the US because there was a fundamental difference between US and UK law:[47]

> "… an important element to understanding this rule is that in American law 'Where third parties aid and abet a fiduciary's breach of duty to creditors… the creditors may bring an action in their own right against such parties.'"[48]

Lord Mance ultimately concluded that the "sole actor" rule was irrelevant because, in direct contradiction to Lord Phillips, he believed an auditor's duty,

[45] Ibid [109], [110].
[46] Ibid [234].
[47] Ibid [239].
[48] *Re The Mediators Inc* (1997) 105 F 3d 822, 825.

where a company was insolvent, was not just (if at all) to shareholders, but also (perhaps only) to creditors, like the duty of directors.[49]

Clearly in *Bilta*, Lord Justice Patten preferred the arguments of the dissenting judges in *Stone & Rolls*, but could he avoid being bound by those of the majority?

COULD *STONE & ROLLS* BE DISTINGUISHED?

Unsurprisingly, the corporate defendants in *Bilta* put the same two arguments as the auditors did in *Stone v Rolls*, namely:

1. The Company was not the primary victim – that was the VAT man – so non-attribution using the *Hampshire Land*/primary victim rationale(s) was not possible. The Company's inability to pay the VAT was an integral part of the fraud, ie the Company was a primarily a perpetrator.
2. The total control of Mr Nazir and Mr Chopra meant that the Company was a one-man company and so attribution fell within the "sole actor" exception. There were no innocent participators in the company prejudiced by the company's inability to obtain damages or compensation.

In general, Lord Justice Patten pointed out that these two arguments were only accepted by two out the five Lords in *Stone & Rolls*, Lords Walker and Brown. Lords Scott and Mance firmly rejected them and the "swing vote" of Lord Phillips was based on his view that the duty of the auditors was limited, ie only owed to, here entirely fraudulent, shareholders and not to creditors. So Lord Justice Patten concluded by asking:

> "But are we bound by [the] *Stone & Rolls* [case] to apply the sole actor exception in this case [*Bilta*] case? I do not believe we are. The issue on that appeal concerned a claim by the company against its auditors who were not party to the fraud on the bank but were negligent in not alerting the company to its existence. Both this court and the House of Lords have decided that [*Re Hampshire Land Co*] did not prevent attribution in that case. There is, however, a significant difference between the liability of an auditor for failing to notify the company about what was taking place and a conspiracy against the company by its directors and others to deprive it of its assets. The claim against the auditors was a claim against a third party who owed

[49] *Liquidator of West Mercia Safetywear Ltd v Dodd & Another* [1988] BCLC 250 (CA).

> no fiduciary duties as such to the company or its creditors based on what in the context of that claim was secondary damage caused to the company by a separate breach of duty on the part of the company's own director. It is therefore readily distinguishable from what we have to consider. The decision in [the] *Stone & Rolls* [case] should be confined in my view to the claim and the facts in that case." [50]

Again, the ever resourceful Lord Justice Patten, here came up with a rationale that does not appear anywhere in *Stone & Rolls* itself. Only one out of five Law Lords, Lord Phillips, suggested that the decision turned on the limited nature of the auditor's duty, and then not the distinction drawn here. Indeed, Lord Mance thought the scope of the auditor's duty similar to that of a director and there is at least one Court of Appeal decision suggesting that the duty might include, where there is no innocent board member/shareholder to report to, reporting matters to the authorities.[51] However, before coming to any conclusions about the current state of the law in this area, two further Court of Appeal decisions not cited in *Bilta* but theoretically binding the court, should be considered.

SAFEWAY STORES

In *Safeway Stores Ltd v Twigger*[52] the Claimant Companies admitted to breaching section 2(1) of the Competition Act 1998 and because it was accepted that the infringement had been committed "negligently or intentionally by the undertaking" under section 36 of the same Act, the Claimant Companies were subject to a penalty of between £10.5 and £16.5 million. Now the Companies were seeking an indemnity and damages from the directors and managers who had involved them in the breach. These directors and managers raised the defence of *ex turpi causa*, claiming that as their intention was attributed personally to the Companies, they were in effect co-conspirators. At first instance, this argument was rejected by Justice Flaux because he believed that the Companies' liability was arguably only vicarious and arose from the general rules of agency, unless it could be shown at full trial that each of the defendants was a "directing mind and will" of the Companies.[53]

This decision was overturned by the Court of Appeal. As Lord Justice Longmore said:

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[50] *Bilta* (n 24) [81].
[51] *Sasea Finance Ltd v KPMG* [2000] 1 All ER 676 (CA) 684.
[52] [2010] EWCA Civ 1472; [2011] 2 All ER 841 .
[53] *Safeway Stores Ltd. v Twigger* [2010] EWHC 11 (Comm); [2010] 3 All ER 577 [68], [74], [75].

> "… 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 [*ex turpis causa*] maxim."[54]

He went on to reject the application of *Hampshire Land.*[55] This does not seem to be consistent with Lord Justice Patten's views on the scope of non-attribution in *Bilta*:

> "… when it forms the subject matter of the action by the company against those whose breach of duty has caused it. In that context the damage is not secondary but primary and the company against those whose breach of duty has caused it. In that context the damage is not secondary but primary and the company is the direct victim of the breach of duty relied on."[56]

However, Lord Justice Pill explained why, in *Safeway Stores*, there might be a particular public policy behind rejecting the application of *Hampshire Land* to this part of the competition legislation:

> "The policy of the 1998 Act is to protect the public and to do so by imposing obligations on the undertaking specifically. The policy of the statute would be undermined if undertakings were able to pass on the liability to their employees or the employees' D&O (directors and officers) insurers. Only if the undertaking itself bears the responsibilities and meets the consequences of their non-observance are the public protected… [T]he provisions of the 1998 Act may be contrasted with those in Part 6 of the Enterprise Act 2002 which created a criminal offence of dishonesty in agreeing to make identified anti-competitive agreements. Under that statute the offence can be committed only by individuals."[57]

It is interesting to note that in a case of primary attribution, a director voting at a board meeting in favour of an improper course of action by the

[54] *Safeway Stores* (n 52) [27].
[55] Ibid [29].
[56] *Bilta* (n 24) [45].
[57] *Safeway Stores* (n 52) [44].

company may not be personally liable unless his involvement in the course of action is more direct.[58]

ROZEIK

In *R v Rozeik*,[59] Rozeik was appealing his conviction for dishonestly obtaining property (namely cheques) by deception under section 15 of the Theft Act 1968. He had provided two finance companies with false invoices for property when entering into hire purchase agreements, but there was some evidence that the branch managers at the two finance companies knew that the information was false. At first instance, however, Judge David Smith QC instructed the jury that "If any employee of the company was deceived by that invoice into doing something which resulted in a cheque being obtained, then the prosecution have proved the case." [60]

Lord Justice Leggatt, giving the judgment of the Court of Appeal, summarised the law thus:

> "Whether or not a company is fixed with the knowledge acquired by an employee or officer will depend on the circumstances. It is necessary first to identify whether the individual in question has the requisite status and authority in relation to the particular act or omission in point…[61] An employee who acts for the company within the scope of his employment will usually bind the company since he is the company for the purposes of the transaction in question…[62] The company may be liable to third parties or be guilty of criminal offences even though that employee was acting dishonestly or against the interests of the company or contrary to orders. But different considerations apply where the company is the victim and the employee's activities have caused or assisted the company to suffer loss. The company will not be fixed with knowledge where the employee or officer has been defrauding it… In such a case knowledge of a manager is not to be imputed to his employers if the manager is acting in fraud of his employers and the knowledge which

[58] *MCA Records Inc v Charly Records Ltd (No. 5)* [2001] EWCA Civ 1441; [2003] 1 BCLC 93 cf *Koninklijke Philips Electronics NV v Princo Digital Disc GmbH* [2003] EWHC 2588 (Pat); [2004] 2 BCLC 50.
[59] [1996] 1 WLR 159 (CA).
[60] Ibid 161.
[61] *El Ajou* (n 26) 696.
[62] *Director General of Fair Trading v Pioneer Concrete (UK) Ltd. and Another* [1995] 1 AC 456 (HL) 465.

> he has is relevant to the fraud…[63] The reason why the company is not visited with the manager's knowledge is that the same individual cannot both be party to the deception and represent the company for the purpose of its being deceived."[64]

So, if it had been proved that the managers had been dishonest, in effect working with Rozeik, then their knowledge would not have been attributed to the company and the company would have been deceived and both Rozeik and the managers guilty under section 15. However, the managers had not been called as witnesses, and so without any clear evidence of their dishonesty, their possible knowledge could be attributed to the company and so there was a doubt that the company was deceived. Rozeik's conviction was quashed.

Lord Justice Leggatt's "circumstance" based approach as to when the normal rules of attribution are overridden in the criminal sphere is very much in line with Lord Justice Patten's "context" based approach in the civil sphere.

IS *HAMPSHIRE LAND* DEAD?

Clearly in one sense *Hampshire Land* is very much alive. It is remarkable that a 1st instance decision dating from before many of the key House of Lords decisions on Company Law,[65] is still cited so often.[66] This is so, even though the actual decision in the case would almost certainly now fall to be decided under what has become section 40 of the Companies Act 2006. Nevertheless, as this brief survey of some of the cases citing *Hampshire Land* shows, the original rationale given in *Hampshire Land* has to be doubted, at least outside the area where a company's legal position is determined by the attribution or non-attribution of mere knowledge. Where, attribution is of dishonest, intentional or reckless thoughts and actions, the implausible width of the rationale was highlighted by Lord Justice Mummery in *Morris v Bank of India*[67] and most recently by Lord Justice Patten in *Bilta*[68] where he went on to say:

> "In particular, the rationale based on the inherent unlikelihood of the director disclosing his own fraud to the object of his deceit might be

[63] *Attorney General's Reference* (n 17).
[64] Ibid 164.
[65] Not just *Brown* (n 2) and *Lennard's* (n 3), but even by a few months, the House of Lords decision in *Salomon v A Salomon & Co Ltd* [1897] AC 22 (HL).
[66] 30 times since 2000 in WestLaw, ie over twice a year.
[67] *Morris* (n 20) [114].
[68] *Bilta* (n 24) [41].

> thought to apply even where the intended victim was not the company, of which he was a director or officer but was a third party."[69]

That has been clearly rejected with the development of the primary victim rule; but as Lord Justice Patten pointed out, the primary victim restriction on the application of the *Hampshire Land* rationale is not a complete explanation of when a company should or should not have the improper thoughts and actions of its agents attributed to it. Even if the company is a primary victim, the "liability cases" show that attribution of such thoughts and actions should be allowed to determine the company's liability to third parties.[70] On the other hand, Lord Justice Patten also believed that there should be no attribution even if the company is a secondary victim and the company is suing its agent for breach of duty. This seems to have been the position of Lord Justice Leggatt in *Rozeik* when he considered attribution and non-attribution in a criminal context.[71]

There is at least one case where a company was clearly suing its agents as a secondary victim, *Safeways*,[72] where the Court of Appeal refused to make an exception to attributing improper thoughts and actions to the Company. However, as Lord Justice Pill highlighted, the legislation was itself in an unusual form.[73] Most legislation creating criminal or other liabilities does so in terms appropriate for individuals and leaves it to the courts to interpret, now guided by *Meridian*,[74] whether and how it might be applied to companies. The Competition Act 1998 clearly makes the "undertaking" liable and Lord Justice Pill's interpretation of the public policy behind that is itself an example of following the approach of Lord Hoffmann in *Meridian.*

This leaves the House of Lords decision in *Stone & Rolls.*[75] In *Bilta*, Lord Justice Patten ingeniously managed, in effect, to adopt the arguments of the two dissenting judgments in *Stone & Rolls.* As a matter of making sense of this area of law, I have enormous sympathy with Lord Justice Patten. In what was his final UK judgment before retirement, Lord Scott in *Stone & Rolls* ended an exemplary career as a judge interpreting Company Law, even if, as in that case, he sometimes failed to convince his fellow judges.[76]

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[69] Ibid [41].
[70] Ibid [34].
[71] *Rozeik* (n 59) 164.
[72] *Safeway Stores* (n 52).
[73] Ibid [44].
[74] *Meridian* (n 5).
[75] *Stone & Rolls* (n 34) 1391.
[76] For a much earlier example of when his fellow judges should have heeded Sir Richard Scott V-C as he then was, see his 1st instance judgment in *Equitable Life Assurance Society v Hyman* [1999] Pens LR 297 (Ch), dismissed by the House of Lords with disastrous consequences at [2002] 1 AC 408 (HL).

Nevertheless, until the Supreme Court revisits this area, lower courts still have to deal with Lords Walker and Brown's explanation of *Hampshire Land* and its limitations. Fortunately, a Supreme Court decision is imminent as permission to appeal *Bilta* to the Supreme Court was granted in February 2014 and the hearing is set for the autumn.

The truth is that the law has moved so far away from the original rationale in *Hampshire Land* that it is time to kill it off. Perhaps when the Supreme Court does consider *Bilta*, the one element of Lords Walker and Brown's judgments in *Stone & Rolls* that should be adopted is to rename the rule or rules on non-attribution as the "adverse interest" principle and then consign the use of *Hampshire Land* to history.