COMPANY LAW REVIEW:
ATTRIBUTION OF LIABILITY

ADVICE

SUMMARY

1. A company, though an abstraction, is treated by the law as an independent person with its own rights and liabilities.

2. Its decisions, however, must be taken and its business conducted by natural persons, that is by individuals.

3. The law has developed rules of attribution to decide, according to circumstances, when the acts or omissions of an individual who is an employee or agent of a company will be treated as the acts or omissions of the company, or as the responsibility of the company.

4. For most purposes of civil liability acts and omissions (and knowledge) may be attributed to a company:

(a) in accordance with its own, or primary, rules of attribution, to be found in its constitution or implied by company law; and, in combination with such rules,

(b) in accordance with general rules of attribution that apply also to individuals, for example agency and vicarious liability.

5. Generally the basis on which a company is responsible in tort for acts or omissions of an employee or agent that injure a third person is vicarious liability.

6. A company is civilly liable for a fraudulent misrepresentation made by one of its directors or officers to a third party if the director or officer made it acting within the scope of his actual or apparent authority as an employee or agent of the company, and whether he made it for the benefit of the company or for his own benefit.

7. Whether the director or officer was acting within his actual or apparent authority is primarily a question of fact. For this reason the ambit of the implied actual or apparent authority of a particular office, for example that of company secretary, may change over time.

8. In most if not all cases where the acts or omissions of a director or officer who is an employee or agent of a company renders his principal, the company, vicariously liable it is because the director or officer is in breach of a duty which he personally owes to the injured party. In those circumstances he will be treated as a joint tortfeasor with the company.

9. Where, however, the duty to the victim is owed solely by the company, a director or officer will usually not be liable. Thus, for example, where a company has assumed a responsibility giving rise to a duty of care to a third party but a director, even a controlling director, has not, only the company will be liable to the third party in the event of a breach of that duty, even if the director's own carelessness is the cause of the damage.

10. A director or officer is liable for his own acts and omissions where they constitute a tort (as a joint tortfeasor with the company where it is vicariously liable for them); and he is liable for the acts and omissions of other employees or agents of the company where it is on his orders, instructions or directions that those specific acts or omissions occurred; provided, if some special state of mind is required for him to be liable, he has that state of mind.

11. It is probable that the damages recoverable from auditors by a company or its liquidator for damage suffered as a result of a negligently conducted audit can be reduced to reflect the extent to which the negligence of a director contributed to the damage, as his fault will probably be attributed to the company.

12. Where, however, the relevant conduct of the director constitutes a fraud, or part of a fraud, on the company, it seems doubtful whether the English courts will attribute his fault to the company, although (in our view) a more satisfactory result would be achieved if they were to.

13. The reasoning in *Caparo* protects companies as well as auditors from claims by third parties that they have suffered loss from relying on inaccurate and negligently prepared annual accounts. If the case is reversed by statute it needs to be made clear whether the modification extends to companies as well as auditors.

INTRODUCTION

14. In *Salomon v. Salomon & Co* [1897] AC 22 Lord Halsbury LC called a company an "artificial creation of the Legislature"[1], but went on to observe:

[1] Page 29.

> "… once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself … ."[2]

15. A company, however, is an abstraction. As Viscount Haldane LC says in *Lennards' Carrying Company, Limited v. Asiatic Petroleum Company, Limited* [1915] AC 705:

> "It has no mind of its own any more than it has a body of its own … ."[3]

It is a legal person, but not a natural person.

16. Necessarily a company's decisions are taken, and its business is conducted, by individuals.

17. These individuals are sometimes agents of the company and sometimes its employees. Inevitably, however, such individuals are not always acting as agents or employees of the company. They have private lives of their own and sometimes other businesses to carry on and other companies to direct or act for.

18. This may all seem obvious. But it can be the source of great difficulty if such an individual, by act or omission, injures a third party and it is necessary to establish whether the individual, or the company, or both are liable in tort to that third party. In particular, what are the relevant legal rules to tell us what acts and omissions count as acts and omissions of the company?

19. It is these difficulties that the Consultation Paper "Developing the Framework" addresses at paragraphs 3.98 to 3.103; and it is these with which we must grapple before tackling the particular problems relating to the liabilities of auditors dealt with later in the Consultation Paper.

20. For convenience, we reproduce at Appendix 1 paragraphs 3.98 to 3.103 of the Consultation Paper. Paragraph 3.101 begins:

> "First, it is not clear whether a company is liable for the acts of a director or other officer if the wrong in question is a fraud or other deliberate act."[4]

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2 Page 30.
3 Page 713.
4 Page 55.

The footnote to this sentence refers to *Grant v. Norway* (1851) 10 CB 665 and to *George Whitechurch Limited v. Cavanagh* [1902] AC 117 and then continues:

> "There appears to be some confusion between the doctrine of attribution as it operates in criminal cases and the civil law theory of vicarious liability."[5]

Paragraph 3.102 begins:

> "Second, it is not clear whether a director who commits a wrong in the course of his duties on behalf of the company is himself personally liable to the third party, and therefore liable to compensate the company (his liability under any contract of employment apart) if it is found vicariously liable on his behalf."[6]

21. For reasons we shall explain, the problem here is as much with the way these propositions are stated as with the legal difficulties underlying them. As to the first point, we do not think there is in most cases any great difficulty in stating, as a matter of law, what circumstances are required to make a company liable to a third party for the fraud of a director or other officer.[7] What can be very difficult is establishing whether those circumstances exist.

22. As to the second point, as stated the question largely answers itself. If a director does indeed "commit a wrong" in circumstances where the company is vicariously liable for that wrong the director will almost certainly be personally liable for it: see *New Zealand Guardian Trust Co. Limited v. Brooks* [1995] 1 WLR 96 (PC), per Lord Keith at 100A-B. In our view three matters need special consideration. First, there are cases where, even though the acts and omissions complained of are those of an individual agent or employee acting in the course of his employment for the company, no tort at all is committed by that individual, but only by the company. Secondly, there has been some difficulty in formulating the test for the degree of responsibility a director must have for wrongful acts or omissions of other individuals, and for which the company is liable in tort, in order to make him liable for them as well. We deal with these two points together when we come to consider the authorities on the personal liability of directors. Thirdly, a recent Court of Appeal case[8] has cast doubt on what we understand to be the accepted law

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5 Page 55.

6 Page 55.

7 The law on when a judgment obtained by a company can be set aside as a result of fraud, on the other hand, is now very much in doubt. This will not be resolved until *Odyssey Re (London) Limited v. OIC Run-Off Limited* 13 March 2000 (CA) is decided by the House of Lords.

8 *Standard Chartered Bank v. Pakistan National Shipping Corporation* [2000] 1 Ll. LR 218.

on when a director is liable for his own fraudulent representations. With great respect, we believe the case to have been wrongly decided on this issue.

Attribution

23. Our consideration of the legal rules that determine what acts and omissions are to be attributed to a company begins with the judgment of the Privy Council in *Meridian Global Funds Management Asia Limited v. Securities Commission* [1995] 2 AC 500. In that case, unknown to the board of directors, two employees of a company, acting within their authority, used funds under the company's management to acquire certain shares. Under New Zealand law notice had to be given of that acquisition but was not. The question was whether **the company** knew, or ought to have known, that it had acquired the shares. The Privy Council held that it did.

24. Lord Hoffmann said this:

> "Any proposition about a company necessarily involves a reference to a set of rules. A company exists because there is a rule (usually in a statute) which says that a persona ficta shall be deemed to exist and to have certain of the powers, rights and duties of a natural person. But there would be little sense in deeming such a persona ficta to exist unless there were also rules to tell one which acts were to count as acts of the company. It is therefore a necessary part of corporate personality that there should be rules by which acts are attributed to the company. These may be called 'the rules of attribution.'
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> The company's primary rules of attribution will generally be found in its constitution, typically the articles of association, and will say things such as 'for the purpose of appointing members of the board, a majority vote of the shareholders shall be a decision of the company' or 'the decisions of the board in managing the company's business shall be the decisions of the company.' There are also primary rules of attribution which are not expressly stated in the articles but implied by company law, such as
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> 'the unanimous decision of all the shareholders in a solvent company about anything which the company under its memorandum of association has power to do shall be the decision of the company:' see *Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd.* [1983] Ch. 258.
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> These primary rules of attribution are obviously not enough to enable a company to go out into the world and do

> business. Not every act on behalf of the company could be expected to be the subject of a resolution of the board or a unanimous decision of the shareholders. The company therefore builds upon the primary rules of attribution by using general rules of attribution which are equally available to natural persons, namely, the principles of agency. It will appoint servants and agents whose acts, by a combination of the general principles of agency and the company's primary rules of attribution, count as the acts of the company. And having done so, it will also make itself subject to the general rules by which liability for the acts of others can be attributed to natural persons, such as estoppel or ostensible authority in contract and vicarious liability in tort.
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> It is worth pausing at this stage to make what may seem an obvious point. Any statement about what a company has or has not done, or can or cannot do, is necessarily a reference to the rules of attribution (primary and general) as they apply to that company. Judges sometimes say that a company 'as such' cannot do anything; it must act by servants or agents. This may seem an unexceptionable, even banal remark. And of course the meaning is usually perfectly clear. But a reference to a company "as such" might suggest that there is something out there called the company of which one can meaningfully say that it can or cannot do something. There is in fact no such thing as the company as such, no ding an sich, only the applicable rules. To say that a company cannot do something means only that there is no one whose doing of that act would, under the applicable rules of attribution, count as an act of the company."

25. In short, according to the circumstances, for most purposes of civil liability acts and omissions (and, of course, knowledge) may be attributed to a company:

(a) in accordance with its own, or primary, rules of attribution, to be found in its constitution or implied by company law; and, in combination with such rules,

(b) in accordance with general rules of attribution that apply also to individuals, for example agency and vicarious liability.

26. A company's liability in tort will generally, but not always, arise vicariously.

Vicarious liability

27. For present purposes vicarious liability is a doctrine of law whereby responsibility for the tortious acts of A is attributed to B (usually A's employer but sometimes his

principal) so that B is civilly liable for those acts as well as A, and A and B are treated by the law as joint tortfeasors.[9]

28. In *Credit Lyonnais Bank Nederland N.V. v. Export Credits Guarantee Department* [1999] 2 WLR 540 Lord Woolf MR, with whom the rest of their Lordships agreed, said this:

> "The general approach to vicarious liability is clear beyond peradventure. Any number of authoritative statements could be referred to for this purpose. I however take a short passage from the speech of Lord Macnaghten in *Lloyd v. Grace, Smith and Co* [1912] A.C. 716, 737, because Lord Macnaghten was citing from a judgment of Blackburn J. who was in turn reflecting a much approved statement in *Story on Agency*. The passage in the judgment of Blackburn J., was reported in *McGowan & Co v. Dyer* (1873) L.R. 8 Q.B. 141, 145:
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> > 'In *Story on Agency*, the author states, in section 452, the general rule that the principal is liable to third persons in a civil suit "for the frauds, deceits, concealments, mis-representations, torts, negligences, and other malfeasances or misfeasances, and omissions of duty of his agent *in the course of his employment*, although the principal did not authorise, or justify, or participate in, or indeed know of such misconduct, or even if he forbade the acts, or disapproved of them." He then proceeds, in section 456: "But although the principal is thus liable for the torts and negligences of his agent, yet we are to understand the doctrine with its just limitations, that the tort or negligence occurs in the course of the agency. For the principal is not liable for the torts or negligences of his agent in any matters beyond the scope of the agency, unless he has expressly authorised them to be done, or he has subsequently adopted them for his own use and benefit.'
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> This statement makes clear the principle on which vicarious liability depends. It is that the wrong of the servant or agent for which the master or principal is liable is one committed

[9] See also Salmond and Heuston *The Law of Torts* (21st edition) at 431 to 434 where the authors deal with what are arguably exceptions to this general proposition. For present purposes, however, these are immaterial.

> in the case of a servant in the course of his employment, and in the case of an agent in the course of his authority. It is fundamental to the whole approach to vicarious liability that an employer or principal should not be liable for acts of the servant or agent which are not performed within this limitation. In many cases particularly cases of fraud, the question arises as to whether the particular conduct complained is an unauthorised mode of performing what the servant or agent is engaged to do."[10]

29. Lord Woolf made clear that he was speaking generally and the authorities suggest that, particularly in the case of agents, the "just limitations" on the doctrine can be quite stringent. In short and in general terms, however, the position is this. An employer is liable for a tort committed by an employee in the course of his employment.[11] A principal is liable for a tort committed by an agent that the principal instigated, authorised or ratifies; or where the wrongful act or omission of the agent constitutes a breach of a non-delegable duty owed by the principal; or, in some cases, where the wrongful act consists of a representation or statement made by the agent acting within the scope of his actual or apparent authority.[12]

The identification principle

30. In the criminal sphere, by contrast, at common law, a company is not usually guilty of an offence unless the individual in fact responsible can be identified with the company. Such an individual is sometimes described as the company's *alter ego*.

31. The primary test for establishing whether a company can be identified with some natural person, and have attributed to it his acts or omissions and his state of mind, is whether the individual in question is, for the purposes of the transaction in question, "the directing mind and will" of the company. That this is the general attribution rule for common law offences was recently reaffirmed by the Court of Appeal in *Attorney General's Reference (No.2 of 1999)* [2000] 3 WLR 195, per Rose LJ at 213B-214G (corporate liability for gross negligence manslaughter).

32. In *Meridian* Lord Hoffmann pointed out that different rules of attribution may apply to different criminal offences. [13]

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10 Page 546 B-G.

11 In the case of fraud, subject to what is said below.

12 These propositions are adapted from Article 92 of *Bowstead & Reynolds on Agency* (16th edition) Article 92; the scope and justification of the final category in relation to agency is not free from doubt, though, as appears below, the position in relation to fraud seems to be clear: see *Bowstead* at 8-174 and 8-180-185.

13 Or quasi-criminal offences, such as contempt.

> "The company's primary rules of attribution [14] 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. For example, a rule may be stated in language primarily applicable to a natural person and requires some act or state of mind on the part of that person "himself," as opposed to his servants or agents. 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?
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> 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, i.e. 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 into account the language of the rule (if it is a statute) and its content and policy".[15]

33. Thus, in relation to statutory offences, where the application of the identification theory would defeat the policy of the legislation, other rules of attribution will be applied, as in *R. v. British Steel* [1995] 1 WLR 1356 (a prosecution under the Health and Safety at Work Act 1974) or *Meridian* itself.

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[14] See the passage quoted at paragraph 24 above.

[15] Page 507B to F.

34. Pausing here, it is worth stressing Lord Hoffmann's point that, when faced with a statutory provision or rule of substantive law for which a rule of attribution needs to be found, it is necessary to ask: for what purpose is an act, or knowledge or state of mind intended to count as that of the company? We will return to this point when considering the question of contributory negligence by the company.

LIABILITY FOR FRAUDS OF OFFICERS AND DIRECTORS

35. A principal is liable for a fraudulent misrepresentation made by his agent to a third party if the agent, when he makes it, is acting[16] within the scope of his actual or apparent authority, and whether he tells the lies for the benefit of his principal or for his own benefit[17]: *Barwick v. English Joint Stock Bank* (1867) LR 2 Ex 259; *Lloyd v. Grace, Smith & Co.* [1912] AC 716; *Uxbridge Permanent Benefit Building Society v. Pickard* [1939] 2 KB 248 (CA); *Kooragang Limited v. Richardson and Wrench* [1982] AC 462[18]; *Armagas Limited v. Mundogas S.A.* [1986] 1 AC 717; *Credit Lyonnais Bank Nederland N.V. v. Export Credit Guarantee Department* [1999] 2 WLR 540 (HL). A similar rule governs in the case of employees; and though here sometimes "the course of his employment" is substituted for "the scope of his actual or apparent authority", in substance the rule is the same: see *Armagas*, per Lord Keith at 781D-F, where he makes clear that "in this category of case" the two expressions mean the same thing.

36. The development of these principles is described by Lord Keith in *Armagas* at pages 779H to 783A. In his speech, (with which the other Law Lords agreed), Lord Keith traces the history of vicarious liability for fraud from 1700 through to modern times, relying both on authorities where the individual fraudster was an agent and on those where he was an employee.

37. These principles apply with equal force to company directors and officers as to any other employees or agents. Indeed, so far as we know, it has never been suggested otherwise. As Cairns LJ said in *Ferguson v. Wilson* (1866) 2 Ch. App. 77:

> "What is the position of directors of a public company? They are merely agents of a company. The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable; where the liability would attach to the principal, and the principal only, the liability is the liability of the company." [19]

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16 In *Lloyd v. Grace, Smith & Co*, Earl Loreburn LC says "purporting to act" (page 725), doubtless because the employee or agent will usually be doing something his employer or principal has not in fact authorised or may indeed have forbidden. But the concept of apparent authority includes cases where what appears to be authorised is not: so in our view "purporting to" is unnecessary.

17 Where, however, the agent A becomes liable to a third party B as a joint tortfeasor with C in the tort of deceit practiced by C on B on the basis that A and C have a common design to defraud B, and A assists C pursuant to and in furtherance of that design, A's principal D does not become vicariously liable to B simply because of the act of assistance, which is not itself the deceit, is carried out within the scope of A's agency: *Credit Lyonnais***.**

18 Per Lord Wilberforce at 471H – 473B.

19 Pages 89 to 90. See also, e.g. *Fairline Shipping Corporation v. Adamson* [1975] QB 180 at 191 and *C. Evans & Sons Limited v. Spritebrand Limited* [1985] 1 WLR 317 at 323, 330.

It follows that where a company would, as a principal, be liable for the tort of its agent, it is liable for the tort of a director acting as its agent. The problem usually lies in demonstrating that a director or officer who has made a fraudulent misrepresentation was acting within the scope of his actual or apparent authority from the company.

Actual and apparent authority

38. The classic exposition of the relationship between actual and apparent authority is the judgment of Diplock LJ in *Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Limited* [1964] 2 QB 480; though some of what he says in relation to agents of companies must now be read in the light of sections 35, 35A and 35B of the Companies Act 1985.

> "It is necessary at the outset to distinguish between an 'actual' authority of an agent on the one hand, and an 'apparent' or 'ostensible' authority on the other. Actual authority and apparent authority are quite independent of one another. Generally they co-exist and coincide, but either may exist without the other and their respective scopes may be different. As I shall endeavour to show, it is upon the apparent authority of the agent that the [third party] normally relies in the ordinary course of business when entering into contracts.
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> An 'actual' authority is a legal relationship between principal and agent created by a consensual agreement which they alone are parties. Its scope is to be ascertained by applying ordinary principles of construction of contracts, including any proper implications from the express words used, the usages of the trade, or the course of business between the parties. To this agreement the [third party] is a stranger; he may be totally ignorant of the existence of any authority on the part of the agent. Nevertheless, if the agent does enter into a contract pursuant to the 'actual' authority, it does create contractual rights and liabilities between the principal and the contractor … .
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> An 'apparent' or 'ostensible' authority, on the other hand, is a legal relationship between the principal and the [third party] created by a representation, made by the principal to the [third party], intended to be and in fact acted upon by the [third party], that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority, so as to render the principal liable to perform any obligations imposed upon him by such contract. To the relationship so created the agent is a stranger. He

> need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the [third party] by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.
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> In ordinary business dealings the [third party] at the time of entering into the contract can in the nature of things hardly ever rely on the 'actual' authority of the agent. His information as to the authority must be derived either from the principal or from the agent or from both, for they alone know what the agent's actual authority is. All that the [third party] can know is what they tell him, which may or may not be true. In the ultimate analysis he relies upon the representation of the principal, that is, apparent authority, or upon the representation of the agent, that is, warranty of authority.
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> The representation which creates 'apparent' authority may take a variety of forms of which the commonest is representation by conduct, that is, by permitting the agent to act in some way in the conduct of the principal's business with other persons. By so doing the principal represents to anyone who becomes aware that the agent is so acting that the agent has authority to enter on behalf of the principal into contracts with other persons of the kind which an agent so acting in the conduct of his principal's business has usually 'actual' authority to enter into." [20]

39. Robert Goff LJ pointed out in *Armagas* in the Court of Appeal (732A-B) that Diplock LJ's analysis was confined to the apparent authority of an agent to bind his principal to a contract; however, he continued:

> "I, for my part, see no reason why the same principles should not be applicable to other acts by an agent, for example, the making of representations by the agent, provided that it is clearly understood that, to give rise to ostensible authority,

[20] Pages 502 to 504. Until section 711A Companies Act 1985 ('CA 1985') (or a similar provision) comes into force it seems it could theoretically be possible for a defendant company to say that the claimant was on constructive notice of any restriction on the authority of a director (but not of any restriction on the authority of the **board** of directors: section 35A CA 1985) or agent set out in the public documents of the company such as the memorandum and articles. This is notwithstanding the fact that as a result of sections 35, 35A and 35B CA 1985 the company can no longer escape liability on the ground of *vires.*

> the representation by the principal must be to the effect that the agent is authorised to make the representation on his, the principal's behalf, so that the third party is entitled to rely upon it as such."[21]

We have no doubt that that is indeed the law.

40. Clearly if a company director or officer is in fact expressly authorised to make representations of a particular class, and he makes a representation of that class fraudulently to a third party causing him loss, then the company will be answerable for it. For such a director or officer has express actual authority, albeit that his representation will generally be an improper mode of doing what he was authorised to do.

41. Moreover, if a company director or officer is expressly authorised by the company to carry out certain business or acts on its behalf then he will have implied authority to do whatever is incidental to the ordinary conduct of such business, or is within the scope of those acts, and whatever is necessary for the proper and effective performance of his duties.[22] So if acting within the scope of such authority he makes a misrepresentation to a third party causing him loss, the company will be answerable for it. [23]

42. As Diplock LJ points out in *Freeman & Lockyer*, a third party usually deals with an agent in ignorance of the true position. All he knows is what he is told, and what he observes. If those actually authorised to act for a company by words or conduct induce a third party to believe that certain activities are within the authority of a director or officer, in short are part of his job, then, if in the course of those activities the director or officer makes a misrepresentation to that third party causing him loss, the company will be answerable for it.

The problem cases

43. It was because they failed to establish implied actual authority or apparent authority that, in the authorities noted as causing concern in the Consultation Document, the plaintiffs lost. In *Grant v. Norway* (1851) 10 CB 665, holders of a bill of lading signed by a ship's master sued the ship's owners to recover the amount of advances made against the bill although, as it had been discovered, the goods had never been shipped. Jervis CJ asked himself this question.

> "Is it then, usual, in the management of a ship carrying goods on freight, for the master to give a bill of lading for goods

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21 Page 732.

22 Adapted from Article 29 of *Bowstead*.

23 This seems to have been the position in *Doyle v. Olby (Ironmongers) Ltd* [1969] 2 QB 158, at least in relation to Mr. Leslie Olby, a director of the defendant companies: see 160A and 161C-D.

> not put on board? for, all parties concerned have a right to assume that an agent has authority to do all which is usual."[24]

His answer to the question was this.

> "So, here, the general usage gives notice to all people that the authority of the captain to give bills of lading, is limited to such goods as have been put on board; and a party taking a bill of lading, either originally, or by endorsement, for goods which have never been put on board, is bound to show some particular authority given to the master to sign it."[25]

The decision was that a captain had no express or implied actual authority to issue such a bill, and so the owner was not answerable for his doing so: a position since reversed by statute.[26]

44. In *George Whitechurch Limited v. Cavanagh* [1902] AC 117 the House of Lords held that a company was not bound by, or answerable for, the act of its secretary in fraudulently producing certified transfers representing that share certificates specified in those transfers had been lodged in the company's offices when they had not. Lord Macnaghten[27] (with whom Lord Halsbury and Lord Shand agreed) said this:

> "Then comes the question, Is the company bound by the representations of their secretary? That must depend on what authority the secretary had or was held out as having."[28]

He then continued in this way.

> "Now, the duties of a company's secretary are well understood. They are of a limited and of a somewhat humble character."

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24 Page 688.

25 Page 689.

26 Initially, and unsuccessfully, by the Bills of Lading Act 1855; more successfully by the Carriage of Goods by Sea Act 1971; and finally and completely by the Carriage of Goods by Sea Act 1992.

27 Who later delivered the principal speech in *Lloyd v. Grace, Smith & Co.*

28 Page 124.

And he went on to hold that a company secretary had no such authority. Lord James agreed on this point.[29] Lord Robertson, on the other hand, who held that the action failed for other reasons, was extremely doubtful whether, if the secretary's job was to produce a true record, it could be outwith the scope of his duties if he produced a false one.[30]

45. In *Ruben v. Great Fingall Consolidated* [1906] AC 439, the company secretary issued purported share certificates, using the company seal without authority, and forging the signatures of the necessary two directors. Lord Loreburn LC said this:

> "Another ground was pressed upon us, namely, that this certificate was delivered by [the secretary] in the course of his employment, and that delivery imported a representation or warranty that the certificate was genuine. He had not, nor was held out as having, authority to make any such representation or to give any such warranty. And certainly no such authority arises from the simple fact that he held the office of secretary and was a proper person to deliver certificates."[31]

Similar views are expressed by Lord Macnaghten, at page 444 and Lord Davey at page 445.

46. But *Ruben*, and cases like it, must be read in the light of Diplock LJ's comments in *Morris v. C.W. Martin & Sons Limited* [1966] 1 Q.B. 716 at 737:

> "The mere fact that his employment by the defendants gave him the opportunity to steal it would not suffice. The crucial distinction between *Lloyd v. Grace, Smith & Co.* and *Ruben v. Great Fingall Consolidated* is that in the latter case the dishonest servant was neither actually nor ostensibly employed to warrant the genuineness of certificates for shares in the company which employed him. His fraudulent conduct was facilitated by the access which he had to the company's seal and documents in the course of his employment for another purpose: but the fraud itself which was the only tort giving rise to a civil liability to the plaintiffs was not committed in the course of doing that class of acts which the company had put the servant in its place to do."

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29 Pages 133 to 134. Lord Brampton's opinion to somewhat similar effect is, however, coloured by the heresy that a principal can only be liable for a fraud committed for his benefit: see pages 140-141.

30 Page 137.

31 Page 443.

It does not follow from the fact that holding a position in the company makes it possible for someone to commit a fraud that any fraud committed is within the actual or apparent authority of the holder of that position.

47. As Robert Goff L.J. put it succinctly in *Armagas* in the Court of Appeal:

> "… the representation of the principal to be derived from the agent's position is limited to the fact that the agent has the usual authority possessed by a person in that position."[32]

48. The authority usual to a particular position can change with time. In *Panorama Developments (Guildford) Limited v. Fidelis Furnishing Fabrics Limited* [1971] 2 QB 711, a company secretary, without the knowledge of the managing director, fraudulently entered into contracts for the hire of cars supposedly on behalf of the company. Lord Denning MR said this:

> "Mr. Hames' second point is this: he says that the company is not bound by the letters which were signed by Mr. Bayne as 'Company Secretary'. He says that, on the authorities, a company secretary fulfils a very humble role: and that he has no authority to make any contracts or representations on behalf of the company. He refers to *Barnett, Hoares & Co. v. South London Tramways Co.* (1887) 18 QBD 815, where Lord Esher MR said at p. 817
>
> > 'A secretary is a mere servant. His position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all; …'
>
> Those words were approved by Lord Macnaghten in *George Whitechurch Ltd v. Cavanagh* [1902] A.C. 117, 124. They are supported by the decision in *Ruben v. Great Fingall Consolidated* [1906] A.C. 439. They are referred to in some of the textbooks as authoritative.
>
> But times have changed. A company secretary is a much more important person nowadays than he was in 1887. He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Acts, but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the

[32] Page 734B. See also In *Russo-Chinese Bank v. Li Yau Sam* [1910] AC 174 (PC) per Lord Atkinson at 184 and *Uxbridge Permanent Benefit Building Society v. Pickard* [1939] 2 KB 248, per MacKinnon LJ at 258.

> company and enters into contracts on its behalf which come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff, and ordering cars and so forth. All such matters now come within the ostensible authority of a company's secretary."[33]

Salmon LJ made observations to similar effect at 717, and Megaw LJ agreed.

49. The *Panorama Developments* case highlights a central fact in this branch of the law. Whether an agent holding a particular position has actual or apparent authority to carry out particular activities is a question that has to be answered if in the light of the facts of the instant case and current business practice. A court is concerned with the authority usual for the relevant officer of the company in 2000, not 1900. The ambit of that authority is at bottom a question of fact, not of law. What is the authority an officer in that position can usually be expected to have? Unless the company tells a third party otherwise, the third party is entitled to believe that the officer holding that position has that authority and, if the third party does so believe and acts on that belief, the company will be bound on the basis of the doctrine of apparent authority.

50. In *Armagas* the Chartering Manager and Vice-President (Transportation) of a company was authorised to negotiate the sale of a ship belonging to the company. He purported to enter into a simultaneous agreement to take the ship back on charter for three years. The third party knew that the Vice-President had no authority to enter into such a charter without approval from more senior management. The Vice-President, however, told the third party that he had obtained the necessary approval. That was a lie. The plaintiffs sought, amongst other things, to hold the company liable for that lie, but failed.

51. The position in relation to apparent or ostensible authority in cases of fraud is summarised by Lord Keith in this way.

> "The essential feature for creating liability in the employer is that the party contracting with the fraudulent servant should have altered his position to his detriment in reliance on the belief that the servant's activities were within his authority, or, to put it another way, were part of his job, this belief having been induced by the master's representations by way of words or conduct."[34]
>
> ….

[33] Pages 716E to 717B.
[34] Page 781 E to F.

> "At the end of the day the question is whether the circumstances under which a servant has made the fraudulent misrepresentation which has caused loss to an innocent party contracting with him are such as to make it just for the employer to bear the loss. Such circumstances exist where the employer by words or conduct has induced the injured party to believe that the servant was acting in the lawful course of the employer's business."[35]

52. In our opinion this reflects the law in relation to agents as well as employees and where their principals are companies as well as individuals.

53. The principles relating to civil liability for fraudulent misrepresentations by a company's agents are but an example of what Lord Hoffmann, in *Meridian*, analysed as a company using, and making itself subject to, general rules of attribution (in this case agency) equally available to natural persons: see 506B-G. The Consultation Document, however, suggests that there may be confusion between the doctrine of attribution as it operates in criminal cases and the civil law theory of vicarious liability. Before we can discuss that, we need to mention the *Hampshire Land* principle and to deal with the personal liability of directors.

The *Hampshire Land* Principle

54. The civil liability of a principal for the fraud of his agent where that fraud is committed within the agent's actual or apparent authority is sometimes referred to as the *Lloyd v. Grace, Smith* principle. It needs to be contrasted with what is sometimes referred to as the *Hampshire Land*[36] principle, namely that the knowledge and, sometimes, the conduct of an agent acting in fraud of his principal will not, so far as it relates to that fraud, be imputed to the principal.

55. The fullest recent expression of the *Hampshire Land* principle occurs in *Belmont Finance Corporation Limited v. Williams Furniture Limited* [1979] Ch. 250 (CA). In that case Belmont, a company in liquidation, sued a number of defendants, including the majority of its own directors, for conspiracy to procure Belmont to buy shares in another company at a gross overvalue in order to provide the money required to enable some of the defendants to purchase all the shares in Belmont itself. Foster J struck out the claim on the basis that Belmont was itself a party to the conspiracy. In the Court of Appeal, Buckley LJ said this:

> "It may emerge at a trial that the facts are not as alleged in the statement of claim, but if the allegations in the statement of

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35 Page 782H to 783A. For the position where, as between principal and agent, one makes the representation, but only the other knows it is untrue, see *Armstrong v. Strain* [1952] 1 KB 232.

36 *In re Hampshire Land Company* [1896] 2 Ch 743.

> claim are made good, the directors of the plaintiff company must then have known that the transaction was an illegal transaction.
>
> But in my view such knowledge should not be imputed to the company, for the essence of the arrangements was to deprive the company improperly of a large part of its assets. As I have said, the company 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 company; 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."[37]

56. The precise ambit of the principle that **knowledge** of fraud committed against a principal by his agent will not be imputed to the principal has never been delimited. Indeed, there is recent authority to the effect that it applies equally to the attribution of **acts** directed by an agent against his principal.[38]

57. It is, however, not always easy to see quite how this doctrine sits with the *Lloyd v. Grace, Smith* principle: a difficulty raised in *Bowstead* at paragraph 8-207. For where a principal defrauds a third party, he almost always thereby injures his principal, if only by exposing him to a claim from the third party. Moreover, in *PCW Syndicate v PCW Reinsurers* [1996] 1 WLR 1136 (C.A.), a case about, inter alia, whether knowledge of his agent's previous dishonesty is to be attributed to an assured for the purposes of disclosure under s.18 of the Marine Insurance Act 1906, Staughton LJ made clear his view that, where the *Hampshire Land* principle applies, a judge should apply it and not the principle on which *Lloyd v Grace, Smith & Co.* is founded, though the only discussion in Staughton LJ's judgment of the latter principle is of its 18th century ancestors.

58. When deciding in any case what is the relevant principle to apply, it seems to us that it will always be necessary to examine precisely who is claiming, against whom and in respect of what. A third party victim of an agent's fraud should be able to rely on the *Lloyd v. Grace, Smith* principle against the company employing that agent. The company should be able to rely on the *Hampshire Land* principle against a party who has injured the company. However, conflict between the two principles may still arise, as we discuss later in the context of contributory negligence.

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[37] Pages 261 to 262. See the line of English authority beginning with *Re Hampshire Land Co* and continuing with *Gluckstein v Barnes* [1900] AC 240 (HL), *J C Houghton & Co v Nothard Lowe & Wills* [1928] AC 1 (HL) and *Kwei Tek Chao v British Traders & Shippers Ltd* [1954] 2 QB 459:

[38] See *McNicholas Construction Limited by H.M. Commissioners of Customs & Excise* [2000] STC 553, and below; and see the formulation in Snell's *Equity* (13th ed.) at paragraph 4-29.

PERSONAL LIABILITY OF DIRECTORS

59. We have been dealing so far with the liability of companies for fraudulent representations made by their agents. We now turn to a related topic: when is a director personally liable in tort for what he does or fails to do in the course of his duties for the company?

60. Acts and omissions that may give rise to liability to a person ("the victim") in tort are always ultimately the acts or omissions of individuals. Where such an individual is the servant or agent of another person the duties that such acts or omissions may breach may be duties owed to the victim by the individual himself, or by that other person, or by both. And even where the duty is owed to the victim by the individual personally, and not by his employer or principal, the employer or principal may be vicariously liable for the individual's breach of his own duty in which case the individual and his employer or principal will both be liable to the victim as joint tortfeasors.

61. In *New Zealand Guardian Trust Co. Limited v. Brooks* [1995] 1 WLR 96 (PC) the question was whether the directors of a company ("Budget") which under the terms of a debenture trust deed was obliged to furnish to the trustee of the deed regular certificates as to certain aspects of the company's affairs, signed by two of the directors on behalf of all of them, were joint tortfeasors with the company in respect of alleged negligence in the preparation of the certificates. After setting out the facts Lord Keith, delivering the opinion of the Privy Council, said this.

> "Counsel for [the plaintiffs] before the Board did not dispute the existence and continued validity in New Zealand of the rule that the release of one joint tortfeasor from liability operates to release also all the others. The argument was that the effect of … the trust deed was to impose upon the directors of Budget a personal duty owed to [the plaintiffs], quite independent of any duty which might be incumbent on Budget, to exercise reasonable care and skill in the preparation of the requisite certificates. Therefore the directors were not joint tortfeasors with Budget.
>
> The directors' case is that Budget is vicariously liable for the negligence of the directors in the preparation of the certificates and is accordingly a joint tortfeasor with them on that basis."[39]

62. Lord Keith then quoted a passage from *Lloyd v. Grace, Smith & Co.* and continued:

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[39] Page 99.

"The Directors of Budget were its agents, and the question is whether or not they were acting in the course of their agency when they prepared the certificates. There can be no doubt that they were acting in their capacity as directors when they did so, and indeed this was conceded by Counsel for [the plaintiffs]. Further, they were acting within the scope of their agency. They could not have prepared the certificates if they had not been authorised by Budget to do so, and their doing so was for the benefit of Budget because the rendering of the certificates was necessary to the maintenance of the loans to it. It is to be accepted that the directors assumed a personal responsibility towards [the plaintiffs] to see that the certificates complied with the requirements of the trust deed and to exercise reasonable care in their preparation, **but in most if not all cases where the acts of an employee or agent render the employer or principal vicariously liable it is because the employee or agent was in breach of a duty which he personally owed to the injured party.**

There are, of course, cases where the principal or employer himself owes a duty of care to the person who has been injured by the act of the agent or employee. That was the basis of the decision in *Cassidy v. Ministry of Health* [1951] 2 K.B. 343, where it was held that a hospital authority which had undertaken the treatment of a patient owed the patient a duty of care in relation to the treatment, and could not escape liability on the ground that the injury had resulted from negligence on the part of the medical staff who had actually administered the treatment. But vicarious liability can and very frequently does arise in the absence of any duty directly owed by the principal or employer. A familiar instance is that of negligence on the part of the driver of a vehicle. The employer of the driver does not himself owe any duty to users of the highway in relation to the manner of driving of the vehicle, yet is liable for the negligence of his employee. So in the present case the fact that Budget may not itself have owed any duty of care to [the plaintiffs] in relation to the preparation of the certificates does not necessarily mean that it cannot be liable for the negligence of its directors acting within the scope of their authority. It is no doubt possible that the terms of the contract such as that which is here involved may be such as to make it plain that any liability for the negligent preparation of the certificates is to rest on the directors alone, to the exclusion of the company. But their Lordships can find nothing in the general structure of this trust deed or the particular language of clause 6.01 capable of evincing an intention that such should be the position in the present case. Their Lordships were not

> referred to any authority or statement of principle indicating a possible basis of distinction between cases where the negligence of directors acting within the scope of their authority might engage the liability of the company and cases where it does not. In the circumstances they cannot perceive any valid grounds upon which vicarious liability of the company might be negatived in the instant case."[40] (Emphasis added)

The Board went on to hold that the directors and the company were joint tortfeasors and, thus, that the directors could rely on a release given to the company.

63. In *Brooks* the principal was a company and the agents were its directors. The directors were individually personally liable for their own acts of negligence; the company was liable for them as its agents; and all were joint tortfeasors.

64. It is, however, sometimes suggested that company law, by allowing the creation of artificial persons with separate legal personality called companies, has the effect of conferring some form of special immunity on those who direct such companies as regards the law of tort: see Grantham and Rickett: "Directors' 'Tortious' Liability: Contract, Tort or Company Law", (1999) 62 MLR 133. That article suggests this:

> "In terms of the applicable legal principles, careless or negligent conduct by company directors sits uncomfortably at the intersection of company law and the law of torts. While company law places the liability exclusively on the artificial corporate entity, the law of torts imposes liability on the director as the actual tortfeasor. Historically, the law has sought to resolve this conflict by requiring, if the director is to be personally liable, some additional factor beyond the bare commission of the tortious act. In some cases this factor was found in the director having 'procured' the tort or having 'made the tort his own', while more recently the courts have relied upon a notion of an assumption of personal responsibility.
>
> The effect of these additional requirements for personal liability has been to afford directors a considerable privilege. Unless the director has positively abandoned the shield of the company's separate personality, personal liability does not arise even where the director has physically committed the tortious act." [41]

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[40] Pages 99 to100.

[41] Pages 137 to 138. Reliance is also placed on paragraph 9-114 of *Bowstead* which says:

> "Where the agent acts for a company a further feature is introduced, for to hold him personally liable may, especially in the case of one-man

In our view this reflects a serious misunderstanding of the true position. Indeed, taken literally, it would mean a director employed to drive the company's vehicle on the company's business might not be liable personally for damage caused by his own negligent driving; and that is certainly not the law.

65. Corporate personality divorces the owners of the company, the shareholders, from the liabilities of the company and of the business it owns. The company is an independent person. If it commits a tort (by its human employees or agents) the shareholders have no liability: at least none simply by virtue of being shareholders.

66. Again, because the company is an independent person, those who are its directors are not liable if it commits a tort (by its human employees or agents) simply by virtue of being its directors.

67. The same holds good for individuals who are both shareholders and directors, even where the company is for practical purposes owned by one individual who is also the sole or principal director. The company is a separate person and no one is liable for its torts simply by virtue of being a shareholder or a director. Similarly, an individual is not liable for a tort committed by another individual simply by virtue of the fact that both are directors of a company and the company is itself vicariously liable for the tort.

68. But, as we hope we have made clear above, if a director (or indeed any employee or agent of a company) commits a tort in the course of carrying out the company's business, the fact that the company may be liable, vicariously, as well in no way affects the individual's own primary liability for the tort.

69. The authorities referred to below repeatedly stress the importance of respecting the separate legal identity of the company. But that respect for a company's separate legal personality does not make a director immune from liability where all the elements are present that would otherwise make him liable in tort. As Aldous J (as he then was) put it with great simplicity in *PLG Research Limited v. Ardon International Limited* [1993] FSR 197, a patents action:

> "I believe it is clear that a director will not be liable unless his involvement would be such as to render him liable as a joint tortfeasor if the company had not existed."[42]

> companies, be in effect to pierce, or at any rate to ignore, the corporate veil. In such cases clear evidence of a separate wrong, as by ordering the commission of a tort, or a separate assumption of responsibility, will normally be looked for. "

[42] Page 238.

70. Put positively, a director will be liable in tort if the part he plays in relation to the acts or omissions that constitute the tort would render him liable if there were no company in existence.[43] So, if liability for the tort requires a state of mind, then to be liable personally the director must have that state of mind. If it requires the tortfeasor to have assumed a responsibility towards the claimant, then to be liable personally the director must have assumed that responsibility on his own behalf and not just on behalf of the company.

71. In our view, these propositions are clear and supported by weighty authorities. But it is fair to say that some of the judgments referred to below have not always been so plain. And from time to time there have been suggestions that the limited liability status of the corporate principal should somehow affect the position of an individual servant or agent, particularly a director. In our view, this is not correct. But it means we must look at the cases with some care. The area of most difficulty, as will become clear, is defining the degree of participation by a director in the commission of a tort by or on behalf of a company to render him personally liable for it.

The authorities

72. In *Cargill v. Bower* (1878) 10 Ch. D. 502, the question arose as to whether a director of a company was liable for fraudulent misrepresentations made by other directors. Fry J said this:

> "… it is said that, inasmuch as [the defendants] knew that the agents would procure subscriptions, they are responsible for everything which was done in the obtaining of those subscriptions. Now that raises an important question of law, because it is to be observed that the directors themselves are only agents of the company. The agents throughout the country, including Mr. Fullager, were also agents of the company, and Mr. Feigan himself was an agent of the company.[44] To what extent are agents liable for the frauds of their co-agents committed in respect of acts which they know that those co-agents are about to perform? I conceive the general law to be this, that the persons responsible for a fraud are of two classes. First, the actual perpetrators of the fraud, the authors of it, the agents who commit it, the parties to it; those who concur in it, who either do something to produce the fraudulent result, or abstain from doing something which they are under an obligation to the

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[43] Ferris J in *Springsteen v. Flute International Limited* [1999] EMLR 180 at 227 said this meant, "… that it is necessary to look carefully at the conduct of the individual director and to see whether, if it had not been done as agent in the name and on behalf of the company, it would have made the director a joint tortfeasor …". But as Rimer J points out in *MCA Records Inc and Another v. Charly Records Limited and Others* [2000] IP&T 800 that approach can leave the court in doubt as to the factual hypothesis on which it is to work.

[44] Mr. Feigan was a director and the manager of the company; Mr. Fullager was not a director.

> deceived person to do in order to prevent fraud. Secondly, the principal for whom an agent in the performance of his duties as agent commits the fraud is also responsible. But, as a general rule, I think that one agent is not responsible for the acts of another agent, unless he does something by which he makes himself a principal in the fraud."[45]

73. In *Rainham Chemical Works Limited v. Belvedere Fish Guano Company Limited* [1921] 2 AC 465 (HL) Mr. Feldman and Mr. Partridge were directors of a company established to manufacture explosives. Chemicals stored at the factory exploded causing damage to neighbouring property. The Plaintiffs sought to hold Mr. Feldman and Mr. Partridge personally liable, as well as the company, on the ground, inter alia, that they controlled the company. Dealing with that argument, Lord Buckmaster said this:

> "It not infrequently happens in the course of legal proceedings that parties who find they have a limited company as debtor with all its paid-up capital issued in the form of fully-paid shares and no free capital for working suggest that the company is nothing but an alter ego for the people by whose hand it has been incorporated, and by whose action it is controlled. But in truth the Companies Acts expressly contemplate that people may substitute the limited liability of a company for the unlimited liability of the individual, with the object that by this means enterprise and adventure may be encouraged. A company, therefore, which is duly incorporated, cannot be disregarded on the ground that it is a sham, although it may be established by evidence that in its operations it does not act on its own behalf as an independent trading unit, but simply for and on behalf of the people by whom it has been called into existence. In the case of *Salomon v. Salomon & Co.* parties who sought to disregard the existence of the company on these grounds were unable to establish this fact, and they accordingly failed, but the Respondents urged that here the position is quite plain. It seems to have been so regarded by Scrutton L.J. The Master of the Rolls thought the same result was reached by considering that the company was in fact under the sole control of Messrs. Feldman and Partridge as governing directors, and Atkin L.J. by the analogy of cases such as *Penny v. Wimbledon Urban District Council*.
>
> I cannot accept either of these views. **If the company was really trading independently on its own account, the fact that it was directed by Messrs. Feldman and Partridge**

[45] Pages 513 to 514.

> **would not render them responsible for its tortious acts unless, indeed, they were acts expressly directed by them.** If a company is formed for the express purpose of doing a wrongful act or if, when formed, those in control expressly direct that a wrongful thing be done, the individuals as well as the company are responsible for the consequences, but there is no evidence in the present case to establish liability under either of these heads."[46] (Emphasis added)

74. Messrs. Feldman and Partridge in fact lost, but on the ground that they were personally occupiers of the land on which the explosion had taken place, not because they controlled the company.

75. In *Performing Right Society Limited v. Ciryl Theatrical Syndicate, Limited* [1924] 1 KB 1 (CA) the second defendant was the managing director of a company that leased a theatre and employed a band which, without authorisation, performed certain works which were the subject of copyright. The managing director did not know what musical works the band was going to perform; and indeed he was abroad at all material times. In the course of allowing his appeal, Atkin LJ said succinctly:

> "Prima facie a managing director is not liable for tortious acts done by servants of the company unless he himself is privy to the acts, that is to say unless he ordered or procured the acts to be done." [47]

Commenting on *Rainham Chemical Works*, he made it clear that directors who expressly **or impliedly** directed or procured the commission of a tort would be liable.

76. In *British Thomson-Houston Company, Limited v. Stirling Accessories, Limited* [1924] 2 Ch. 33 the plaintiffs attempted to make the individual defendants liable for an infringement of patent merely because they were the only directors and shareholders of the infringing company. Rejecting this argument, Tomlin J said this:

> "Now I apprehend that where it is sought to fix a defendant with liability for a tort it must be established either that he is himself the tortfeasor or that he is the employer or principal of the tortfeasor, in relation to the act complained of, or at any rate the person on whose instructions the tort has been committed.
>
> In the present case it is not alleged that the defendant directors were the actual tortfeasors. It is therefore sought to fix them with liability by contending, first, that in the

[46] Pages 476 to 477. See also Lord Parmoor at 488, and Lord Wrenbury at 491.
[47] Page 14.

> circumstances of the case the defendant company was only a cloak under cover of which the infringements were committed by the defendant directors, or in other words that the defendant company was the agent of the defendant directors to commit the infringements, and secondly, that the true inference from the facts is that the defendant directors authorised the acts of infringement.
>
> There is no evidence of any fact pointing to the relation of principal and agent having been established between the defendant directors and the company, unless the fact that the defendant directors were the sole directors and the sole shareholders of the company can be properly regarded as a circumstance from which the relationship ought to be inferred.
>
> I do not think that any such inference can be or ought to be drawn. It has been made plain by the House of Lords that for the purpose of establishing contractual liability it is not possible, even in the case of the so-called one man companies, to go behind the legal corporate entity of the company and treat the creator and controller of the company as the real contractor merely because he is the creator and controller. If he is to be fixed with liability as principal, the agency of the company must be established substantively and cannot be inferred from the holding of director's office and the control of the shares alone: see *Salomon v. Salomon & Co.* Any other conclusion would have nullified the purpose for which the creation of limited companies was authorised by the Legislature. Nor does the matter stand otherwise in regard to liability for tortious acts. This also has been made plain by the House of Lords in *Rainham Chemical Works v. Belvedere Fish Guano Co. … .*"[48]

77. In *Yuille v. B & B Fisheries (Leigh), Limited and Bates* [1958] 2 Ll. LR. 596, the plaintiff was skipper of a fishing boat owned by the first defendant, a company of which the second defendant was the managing director. The plaintiff suffered severe personal injuries due, amongst other things, to the defective condition of the vessel. Willmer LJ, sitting at first instance, held the second defendant personally liable because his own individual errors of omission constituted a breach of duty to the plaintiff. The judge said this:

> "I see no difficulty, therefore, in law, provided the facts warrant it, in coming to the conclusion that an officer of a

[48] Pages 32 to 38.

> company, whether he be a director or whether he be any other official in the service of the company, is in law capable of being a joint tortfeasor with the company itself, which, of course, would also be vicariously responsible for his wrongful acts.
>
> In those circumstances, it appears to me that, having regard to the defective condition of these various vessels in the respects which I have referred to, and having regard to Mr. Bates's knowledge and means of knowledge, of those defects, he is in the position that he was party to the sending of vessels to sea when he knew, or ought to have known, that they were not in a seaworthy condition. In those circumstances, if injury or damage to a fellow-servant results, it seems to me that there is nothing to prevent that fellow-servant from having his remedy in tort against Mr. Bates personally."[49]

78. In *Fairline Shipping Corporation v Adamson* [1975] QB 180, the plaintiff contracted with a company of which the defendant was the managing director to store goods in a refrigerated store belonging to the defendant personally, but which was used by the company. The temperature in the store was negligently allowed to rise, and the goods were damaged. On the facts, Kerr J held that the director had personally assumed, and owed, a duty of care to the plaintiffs which he had breached.

79. In *Wah Tat Bank Limited v Chan Cheng Kum* [1975] AC 507 (PC), one question was whether the respondent, who was a shipowner who chartered his ships to a shipping company of which he was the managing director, was personally liable in conversion in respect of goods delivered in Singapore without the mate's receipts or any authority from the banks holding those receipts as security for advances. Lord Salmon, delivering the judgment of the Board, said this:

> "No doubt the fact that the respondent is chairman and managing director of H.S.C. does not of itself make him personally liable in respect of that company's tortious acts. A tort may be committed through an officer or servant of a company without the chairman or managing director being in any way implicated. There are many such cases reported in the books. If, however, the chairman or managing director procures or directs the commission of the tort he may be personally liable for the tort and the damage flowing from it: *Performing Right Society Ltd. v. Ciryl Theatrical Syndicate Ltd.* [1924] 1 K.B. 1, 14, 15, *per* Atkin L.J. Each case depends upon its own particular facts. In the instant case the uncontradicted evidence proves that early in 1961 the

[49] Page 619.

> respondent, as chairman and managing director of H.S.C., agreed with the directors of T.S.C. the terms upon which H.S.C. would continue wrongfully to convert goods consigned to the banks just as they had done in the past. Their Lordships consider that, in all the circumstances, there is no answer to the appellants' contention that the respondent was personally liable for the conversion in respect of which judgment has been entered against H.S.C."[50]

80. The line of authority is disturbed by *White Horse Distillers Limited v. Gregson Associates Limited* [1984] RPC 61. Here, the plaintiffs, scotch whisky distillers, claimed that the first defendant, which was a whisky exporter, was liable for passing off because it had supplied Scotch Whisky in bulk to Uruguay for admixture with local spirits. The resulting product was then sold in Uruguay by the first defendant's local distributor labelled "Gregson's Fine Whisky", "… in a manner likely to deceive purchasers or consumers in Uruguay into thinking that they were purchasing or consuming Scotch Whisky."[51] It was also sought to hold two directors of the first defendant personally liable. In the course of his judgment, Nourse J (as he then was) said this:

> "I turn now to the final question, which is whether Mr. Joiner and Mr. Wright or either of them have so acted as to make themselves personally liable for the tort committed by Gregsons. That is a question on which it is not easy to extract any consistent principles from the English authorities. However, Mr. Nicholls was content to rely on the decision of the Federal Court of Appeal of Canada in *Mentmore Manufacturing Co. Ltd. v. National Merchandising Manufacturing Company Inc.* (1978) 89 D.L.R. 195 as correctly stating the law in this respect. That decision was recently applied by Whitford J. in *Hoover PLC v. George Hulme (Stockport) Limited* [1982] F.S.R. 565 at 596 and 597.
>
> The *Mentmore* case was one of patent infringement, but it is not suggested that the test is any different in the case of passing off, or indeed in the case of any other tort. The headnote reads as follows:
>
> > 'An officer of a corporation is not personally liable for corporate acts that constitute a patent infringement unless he deliberately or recklessly pursues a course of conduct likely to constitute infringement.'

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50 Pages 514G to 515B.

51 Page 74, lines 34 to 37.

As will appear, that is an accurate summary of the decision so far as it goes, but it is necessary to give full and careful consideration to certain passages in the judgment of the court delivered by Le Dain J. At page 202, the court expressed the view that what is involved in a case of this kind is a very difficult question of policy requiring the balancing, on the one hand, of the principle that a limited company is a separate entity generally enjoying the benefit of limited liability with, on the other hand, the principle that everyone should answer for his tortious acts. At page 203, the court agreed with the judge below that the fact that the two directors in that case imparted the practical, business, financial and administrative policies and directives which ultimately resulted in the assembling and selling of the infringing goods was not by itself sufficient to give rise to personal liability. The judgment proceeds as follows:

> ‘What, however, is the kind of participation in the acts of the company which should give rise to personal liability? It is an elusive question. It would appear to be that the degree and kind of personal involvement by which the director or officer makes the tortious act his own. It is obviously a question of fact to be decided on the circumstances of each case. I have not found much assistance in the particular case in which courts have concluded that the facts were such as to warrant personal liability. But there would appear to have been in these cases a knowing, deliberate, wilful quality to the participation.’

Reference was then made to four decisions in this country … .

Next the court referred to some American decisions and expressed the view that they should not go so far as to hold that the director must know or have reason to know that the acts which he directs or procures constitute infringement, since that would be to impose a condition of liability that does not exist for patent infringement generally. The judgment proceeds as follows:

> ‘But in my opinion there must be circumstances from which it is reasonable to conclude that the purpose of the director or officer was not the direction of the

> manufacturing and selling activity of the company in the ordinary course of his relationship to it but the deliberate, wilful and knowing pursuit of a course of conduct that was likely to constitute infringement or reflect an indifference at the risk of it. The precise formulation or the appropriate test is obviously a difficult one. Room must be left for a broad appreciation of the circumstances of each case to determine whether as a matter of policy they call for personal liability. Opinions might differ as to the appropriateness of the precise language of the learned trial judge in formulating the test which he adopted - "deliberately or recklessly embarked on a scheme using the company as a vehicle, to secure profit or custom which rightfully belonged to the plaintiffs" - but I am unable to conclude that in its essential emphasis it was wrong.'

Then the Court returned to the facts of that case and concluded that the directors were not personally liable.

Although I do not find it very easy to reconcile all the passages to which I have referred or which I have quoted, I believe that the principles embodied in the *Mentmore* decision can be stated as follows. Before a director can be held personally liable for a tort committed by his company he must not only commit or direct the tortious act or conduct but he must do so deliberately or recklessly and so as to make it his own, as distinct from the act or conduct of the company. It is unnecessary for him to know, or have the means of knowing, that the act or conduct is tortious. It is enough if he knows or ought to know that it is likely to be tortious. The facts of each case must be broadly considered in order to see whether, as a matter of policy requiring the balancing of the two principles of limited liability and answerability for tortious acts or conduct, they call for the director to be held personally liable.

In the light of the position adopted by Mr. Nicholls[52], it is not strictly necessary for me to decide whether the principles so stated represent the law of England. The test for liability which they prescribe is evidently higher than that adopted in

[52] Counsel for the plaintiffs.

> some of the English authorities, for example, in the judgment of Atkin L.J. in *Performing Right Society Ltd v. Ciryl Theatrical Syndicate Ltd* [1924] 1. K.B. 1 at 14 and 15, where it is held to be enough that the director should expressly or impliedly direct or procure the commission of the tortious act. Subject to the question of policy, there is, in my view, much to be said for the higher test, particularly in regard to its requirement that the director should make the act or conduct his own as distinct from that of the company. That would seem to be an entirely rational basis for personal liability. Conversely, it would seem to be irrational that there should be personal liability merely because the director expressly or impliedly directs or procures the commission of the tortious act or conduct. In the extreme, but familiar, example of the one-man company, that would go near to imposing personal liability in every case. As for deliberateness or recklessness and knowledge or means of knowledge that the act or conduct is likely to be tortious, I think that these may on examination be found to be no more than characteristic, perhaps essential, elements in the director's making the act or conduct his own.
>
> Up to this point, I respectfully think that the *Mentmore* test, as I have understood it, correctly represents the law of England. The introduction of considerations of policy, which I take to be capable of overriding the basic principles of liability in any particular case, is more difficult, and I doubt whether they have any place in our law. "[53]

What Nourse J was thus proposing is a test that requires a greater degree of participation in a tort committed by or on behalf of a company to make him personally liable than had previously been thought to be the law.

81. The Court of Appeal had to consider what Nourse J had said a year or so later in the case of *C. Evans & Sons Limited v. Spritebrand Limited* [1985] 1 WLR 317. In that case, the plaintiffs designed, manufactured and supplied scaffolding equipment and alleged that the first defendant company had infringed their copyright in certain drawings of scaffolding components. The plaintiffs claimed similar relief against a director of the defendant company, but merely alleged against him that the acts of the company complained of were acts which the director had personally authorised, directed and procured. Slade LJ, with whom the rest of the Court agreed, said this.

> "The authorities, as I have already indicated, clearly show that a director of a company is not automatically to be

[53] Page 90, line 15 to page 92, line 19.

identified with his company for the purpose of the law of tort, however small the company may be and however powerful his control over its affairs. Commercial enterprise and adventure is not to be discouraged by subjecting a director to such onerous potential liabilities. In every case where it is sought to make him liable for his company's torts, it is necessary to examine with care what part he played personally in regard to the act or acts complained of. Furthermore, I have considerable sympathy with judges, particularly when dealing with commercial matters, who may be anxious to avoid or discourage unnecessary multiplicity of parties by the joinder of directors of limited companies as additional defendant in inappropriate cases. As Mr. Watson emphasised, the very fact of such joinder could in some cases operate to put unfair pressure on the defendants to settle. In some instances where the joinder is demonstrably a mere tactical move, a striking out application may well be justified.

Nevertheless, in my judgment, with great respect to Nourse J. (and to Whitford J. who has since followed him), in expressing a principle in the *White Horse* case said to be applicable to all torts, he expressed it in terms which were not sufficiently qualified. I readily accept that the statements of Lord Buckmaster[54] and Atkin L.J.[55] to which I have referred, themselves cannot be regarded as a precise and unqualified statement of the principles governing a director's personal liability for his company's torts; I do not think they were so intended. In particular, I would accept that if the plaintiff has to prove a particular state of mind or knowledge on the part of the defendant as a necessary element of the particular tort alleged, the state of mind or knowledge of the director who authorised or directed it must be relevant if it is sought to impose personal liability on the director merely on account of such authorisation or procurement; the personal liability of the director in such circumstances cannot be more extensive than that of the individual who personally did the tortious act. If, however, the tort alleged is not one in respect of which it is encumbent on the plaintiff to prove a particular state of mind or knowledge (eg, infringement of copyright) different considerations may well apply.

I do not regard this striking out application as an appropriate occasion for this court to attempt a comprehensive definition of the circumstances in which a director of a company who

54 In *Rainham* at 476.
55 In *Ciryl* at 14.

has ‘authorised, directed and procured’ … a tortious act to be done will be held personally liable. The question which has to be decided on this appeal is a far more limited one: is it the law of England that a director of a company who has authorised, directed and procured the commission by the company of a tort of the nature specified in section 1(2) of the Copyright Act 1956 can *in no circumstances* be personally liable to the injured party unless he directed or procured the acts of infringement in the knowledge that they were tortious, or recklessly, without caring whether they were tortious or not? (I emphasise the words ‘in no circumstances’ because this court, for present purposes, has to assume against the director that evidence at the trial may reveal that his personal involvement with the tortious acts alleged was as close as it could possibly be, short of personal performance of those tortious act.)

For my part, I have no hesitation in answering this question, ‘No’. I can best begin the explanation of my reasons by giving a hypothetical example. Let it be supposed that evidence at the trial reveals that an employee of the defendant company personally manufactured scaffolding components in breach of the plaintiffs' copyrights and that he carried out this operation under the personal supervision and direction of the director, who was present throughout the operation and told him exactly what to do. Section 17(2) and 18(2) of the Copyright Act 1956 impose certain restrictions on the remedies of owners of copyright in cases where it is proved or admitted that at the relevant time the defendant was not aware and had no reasonable grounds for suspecting that copyright subsisted. However, subject to any limited defence which he may be able to established in reliance on either of these subsections, I can see no reason why on the hypothetical facts the employee should not be exposed to personal liability in subsequent proceedings or in these proceedings if added as a party. As Willmer L.J. observed in *Yuille v. B. & B. Fisheries (Leigh) Ltd.* [1958] 2 Lloyd's Rep. 596, 619:

> ‘Of recent years cases have become increasingly common in which servants, sometimes as well as their company, and sometimes by themselves, have been personally sued. It is well-established now that, provided you can fix the responsibility on to a particular individual, a right of suit against that individual exists.’

In my judgment, it would offend common sense if, on the hypothetical facts postulated, the law of tort were to treat the director of the company any more kindly than the servant, who took his orders from the director; and no authority has been cited to us which would compel the court to reach any such conclusion. In my opinion the court would regard the case against the director as falling fairly and squarely within the principle enunciated by Atkin L.J in the *Performing Right Society* case [1924] 1 K.B.1 whether or not mens rea had been alleged against the director in the plaintiffs' pleadings - subject only to any limited defence which the director might establish under section 17(2) or 18(2) of the Act of 1956. The difficulties of accepting, without qualification, Nourse J's broad statement of principle become even more apparent if one postulates the case of a servant of a company who in all innocence has trespassed on another's land and thereby caused damage, on the specific orders of a director who was present on the spot when the trespass occurred, thought he did not cross the boundary but was equally innocent. Since this is a tort of absolute liability, the employee must be liable. Why should the director himself escape scot free, even if he was unaware that his order would give rise to a trespass?

In contrast, on other hypothetical facts, difficult questions of degree might arise as to whether a director had ordered or procured the relevant acts to be done in the sense of the principle broadly expressed by Atkin L.J. – simply, for example, if the sole part which he had played in the relevant tortious act had been that of voting in favour of a relevant resolution at a board meeting. The Federal Court of Appeal of Canada in the *Mentmore* case, 89 D.L.R. 195 eschewed any attempt to give a precise definition of the nature and extent of participation in the tortious act which will render a director who has directed or authorised it personally liable as a joint tortfeasor. As it rightly observed, this is an ‘elusive question,’ a ‘question of fact to be decided on the circumstances of each case.’ Nor, with respect, do I dissent from that court’s assumption that under English law, at least in some cases, broad considerations of policy may be material in deciding which side of the line his participation fell. If there has been no ‘knowing, deliberate, wilful quality’ in his participation, the court may naturally be more reluctant to hold the director personally liable. Lord Salmon himself observed in the *Wah Tat Bank* case [1975] A.C. 507 that ‘each case depends upon its own particular facts.’

> I would prefer to leave the further elucidation of limits of the personal liability of directors to the trial judge by reference to the facts as found by him. For present purposes it will suffice to summarise my conclusions thus: (a) the facts as pleaded in the plaintiffs' statement of claim and further and better particulars are capable of founding a good cause of action against the appellant, **if supported by evidence at the trial sufficiently implicating him personally in infringements of copyright committed by the defendant company**. (b) The appellant's submission that the plaintiffs must further allege and prove mens rea would afford him a wider exemption from liability for infringement than Parliament has seen fit to provide under sections 17(2) and 18(2) of the Copyright Act 1956; I can see no reason, on authority or principle, why he should enjoy such immunity if the facts pleaded in the statement of claim are proved, though it is still open to him to rely on these two subsections for his own protection, if he so chooses."[56] (Emphasis added)

82. A year or so later, another division of the Court of Appeal had to consider an attempt to fix a director with liability for tortious acts committed on behalf of a company by employees and contractors other than him. The court affirmed the liability of the director simply on the basis that he had personally given instructions for the acts which constituted acts of waste to be carried out: *Mancetter Developments Limited v. Garmanson Limited* [1986] QB 1212.

83. Nourse J in *White Horse* appreciated that he was seeking to impose a test for directors' liability significantly higher than that set in the past; and indeed that test was not accepted in *Spritebrand*.[57] But both Nourse J and Slade LJ were clearly troubled by similar doubts. Does not incorporation change a person's liability for what was formerly his business? What is the position for one-man companies? And in bigger companies, what is the liability of a director whose only role is to vote for a board resolution? Similar unease is reflected in the New Zealand judgments we come to shortly.

84. The right principle, we suggest, is that the independent existence of the company as employer or principal must be respected. But where someone is acting as the agent of a principal, he will be personally liable for torts committed in the course of that agency in the same circumstances where the principal is a company as where the principal is an individual. Thus a director will be liable for his own acts and omissions where they constitute a tort; and he will be liable for the acts and omissions of other employees and agents of the company where it is on his orders, instructions or directions that those specific acts or omissions occurred, provided, if some special state of mind is required to

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[56] Pages 329 to 331.

[57] Per Slade LJ at 329.

be liable, he has that state of mind.[58] In short, if the extent of his participation in the tort would have been sufficient to make him liable as a joint tortfeasor had he not been acting in his capacity as a director, he will be liable as a joint tortfeasor notwithstanding that he was so acting.

Torts involving assumption of responsibility

85. In *Trevor Ivory Limited v. Anderson* [1992] 2 NZLR 517 (New Zealand Court of Appeal) the plaintiffs had engaged what was in effect a one-man company to advise on the use of herbicides. Mr. Ivory was the main shareholder and managing director of the company and he gave the advice. It was wrong and was given negligently; many of the plaintiffs' raspberry plants were lost. Reversing the judge below, the New Zealand Court of Appeal held that Mr. Ivory was not liable because he had never, in a personal capacity, assumed responsibility to the plaintiffs for the advice given. Cooke P said this:

> "In this field I agree with Nourse J (as he then was) in the *White Horse* case that it behoves the Courts to avoid imposing on the owner of a one-man company a personal duty of care which would erode the limited liability and separate identity principles associated with the names of Salomon and Lee. Viewing the issue as one of the assumption of a duty of care, which is the way in which Mr. Fogarty for the respondents rightly asked us to view it, I cannot think it reasonable to say that Mr. Ivory assumed a duty of care to the plaintiffs as if he were carrying on business on his own account and not through a company."[59]

86. Hardie Boys J agreed, saying:

> " An agent is in general personally liable for his own tortious acts: *Bowstead on Agency* (15th ed., 1985) at p 490. But one cannot from that conclude that whenever a company's liability in tort arises through the act or omission of a director, he, because he must be either an agent or an employee, will be primarily liable, and the company liable only vicariously. In the area of negligence, what must always first be determined is the existence of a duty of care. As is always so in such an inquiry, it is a matter of fact and degree, and a balancing of policy considerations. In the policy area, I

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[58] But he will not be liable, provided he is acting bona fide within the scope of his agency, if he procures or induces his principal to break a contract with a third party, for then he is treated as being solely the alter ego of his principal, and a man cannot be sued for inducing himself to break a contract: *Said v. Butt* [1920] 3 KB 497; *D.C. Thomson & Co.Ltd v. Deakin* [1952] 1 Ch. 646 (CA); *Lathia v Dronsfield Bros Ltd* [1987] BCLC 321; *Welsh Development Agency v. Export Finance Co. Ltd* [1992] BCLC 148 (CA).

[59] Page 523.

> find no difficulty in the imposition of a personal liability on a director in appropriate circumstances. To make a director liable for his personal negligence does not in my opinion run counter to the purposes and effect of incorporation. Those purposes relevantly include protection of shareholders from the company's liabilities, but that affords no reason to protect directors from the consequences of their own acts and omissions. What does run counter to the purposes and effect of incorporation is a failure to recognise the two capacities in which directors may act; that in appropriate circumstances they are to be identified with the company itself, so that their acts are in truth the company's acts. Indeed I consider that the nature of corporate personality requires that this identification normally be the basic premise and that clear evidence be needed to displace it with a finding that a director is acting not as the company but as the company's agent or servant in a way that renders him personally liable … .
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> Essentially, I think the test is, or at least includes, whether there has been an assumption of responsibility, actual or imputed. That is an appropriate test for the personal liability of both a director and an employee." [60]

87. In *Williams v. Natural Life Health Foods Limited* [1998] 1 WLR 830 (HL), Mr. Mistlin was the managing director and principal shareholder of a health food company. The plaintiffs entered into a franchise agreement with the company on the basis of detailed financial projections sent to them by the company. Although Mr. Mistlin had played a major part in preparing the projections, the plaintiffs' own dealings were entirely with another employee of the company. The company's brochure made clear that its expertise to provide advice derived from Mr. Mistlin's experience in the health food trade. The projections were wrong and had been prepared negligently. The plaintiffs sued the company, and when it was wound up they joined Mr. Mistlin. The trial judge and the Court of Appeal (by a majority) found Mr. Mistlin liable. The House of Lords unanimously reversed this. Lord Steyn, with whom the other law lords agreed, said this:

> "… Waite L.J. took the view that in the context of directors of companies the general principle must not 'set at nought' the protection of limited liability. In *Trevor Ivory Ltd v. Anderson* [1992] 2 N.Z.L.R. 517, 524 Cooke P. expressed a very similar view. It is clear what they meant. What matters is not that the liability of the shareholders of a company is limited but that a company is a separate entity, distinct from its directors, servants or other agents. The trader who incorporates a company to which he transfers his business

[60] Pages 526 to 527.

> creates a legal person on whose behalf he may afterwards act as director. For present purposes, his position is the same as if he had sold his business to another individual and agreed to act on his behalf. Thus the issue in this case is not peculiar to companies. Whether the principal is a company or a natural person, someone acting on his behalf may incur personal liability in tort as well as imposing vicarious or attributed liability upon his principal. But in order to establish personal liability under the principle of *Hedley Byrne*, which requires the existence of a special relationship between plaintiff and tortfeasor, it is not sufficient that there should have been a special relationship with the principal. There must have been an assumption of responsibility such as to create a special relationship with the director or employee himself." [61]

88. Although Lord Steyn was concerned with a case of responsibility for the negligent provision of services what he had to say is, in our view, of general application. The agent of a corporate principal is in the same position as the agent of an individual principal. Moreover, for an individual agent to be personally liable for a tort, all the elements necessary for any individual to be personally liable must be present. If the tort requires an assumption of responsibility and the only assumption of responsibility is one by (that is, attributable to) the company, then the agent cannot be liable for a breach of duty, which is owed by the company alone. By parity of reasoning, if liability for a tort requires a particular state of mind, to be liable the agent must personally have that state of mind.

89. It is, however, worth stressing that the decision in *Williams* exposes a class of torts where it is critical whether the individual whose acts or omissions caused the victim loss is an employee or agent acting as such. If liability depends on an assumption of responsibility to the victim (for example, negligent misstatement) and that responsibility is assumed by the employer or principal and not by the employee or agent, then only the employer or principal can be liable. This is to be contrasted with more traditional torts, like negligent driving, where as Lord Keith pointed out in *Brooks*, the employer or principal is liable, vicariously, because the employee or agent breaks a duty which he personally owes to the injured party.

Conclusion

90. In our view, the law relating to the personal liability of a director for wrongful acts committed in the course of his duties on behalf of the company (to echo paragraph 3.102 of the Consultation Paper) is reasonably clear. If the acts or omissions are his own, he is liable if, ignoring the existence of the company, all the necessary elements of the tort can be proved against him. If the acts or omissions are those of others, he is liable provided he

[61] Pages 834H to 835C.

is sufficiently personally implicated in them (to echo Slade LJ in *Spritebrand*).[62] Even though it has been described as "an elusive question",[63] we do not believe that in practice the courts have ever found it difficult to decide **on the facts** what constitutes sufficient involvement.[64] The traditionally used words include, "order", "procure", "instruct" and "direct". We doubt if their replacement with statutory words would help. As Lord Salmon said in *Wah Tat Bank*, "each case depends upon its own particular facts."[65]

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62 These are, of course, general propositions. For example, in the case of the tort of inducing breach of contract the rule in *Said v. Butt* applies (see the note to paragraph 84 above); and in the case of statutory torts, such as section 16(2) of the Copyright Design and Patents Act 1988, whether and in what circumstances a director can be liable will depend also on the construction of the statute.

63 See per Slade LJ in *Spritebrand* at 330.

64 In *White Horse* itself, albeit applying his own test, Nourse J had no difficulty in deciding one director was liable and one was not.

65 Page 515. We agree with the view expressed by Rimer J in *MCA Records Inc and Another v. Charly Records Limited and Others* [2000] IP&T 800 that in the passage in *Williams* where Lord Steyn rejected the suggestion that Mr. Mistlin might be liable as a joint tortfeasor for having directed that the negligent projections be supplied to the plaintiffs, he did not intend to cast doubt on the line of authority establishing that a director is liable if he directs the commission of a tort. The point Lord Steyn was making was that Mr. Mistlin could not be liable as a joint tortfeasor for a tort that required an assumption of responsibility to be liable where he himself had never assumed such a responsibility: see pages 838E to 839A.

Confusing the civil and criminal rules

91. Advocates and judges are frequently tempted to import concepts derived from the criminal law into the civil field.

92. In *Credit Lyonnais Bank Nederland NV v. ECGD* [1999] 1 Ll.R. 563 (HL) Mr. Pillai, an employee of ECGD, had helped a Mr. Chong to defraud the bank. Mr. Pillai, on behalf of ECGD, had issued a series of guarantees to the bank covering the bank's purchase from Mr. Chong of bills of exchange drawn in respect of fictitious export transactions supposedly entered into by companies which Mr. Chong owned or controlled. But although Mr. Pillai was acting pursuant to and in furtherance of their common fraudulent design, he himself, whilst acting within the course of his employment, never made a false statement or forged any documents.[66]

93. The bank failed in its attempt to hold ECGD vicariously liable for the fraud. In the Court of Appeal the bank, in part relying on the analogy of accessory liability for crimes, argued that there was a tort of knowing assistance in the commission of a tort by another person (i.e. knowing assistance by Mr. Pillai in Mr. Chong's deceit upon the bank), and that the employer (ECGD) of the person assisting (Mr. Pillai) was vicariously liable for that assistance even though there might not be vicarious liability for the primary act (Mr. Chong's deceit) itself. These arguments were comprehensively rejected by the Court of Appeal. In the course of his judgment Hobhouse LJ distinguished three categories of criminal liability.[67] Firstly, criminal liability not dependent on commission of the principal crime (e.g. conspiracy or incitement); secondly, aiding or abetting the commission of a crime by another person; and thirdly, criminal liability based on agency, where the defendant is held responsible for an act carried out by another person because it formed part of a joint enterprise. After extensive consideration of the authorities Hobhouse LJ concluded:

> "It is only conduct which comes into the first or the third of the categories I have set out above which constitute the commission of a tort. The criminal law for obvious policy reasons goes further than the civil law. Acts which knowingly facilitate the commission of a crime amount to the crime of aiding and abetting but they do not amount to a tort or make the aider liable as a joint tortfeasor."[68]

94. The Court firmly rejected the idea that vicarious liability for fraudulent statements can be based on the fact that the agent did things, not in themselves fraudulent, within the scope of his agency that facilitated the commission of the fraud.

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66 He did write false letters, but this had not been within the scope of his actual or apparent authority.

67 [1998] 1 Ll. L.R. 19, 42 to 47; these categories were not intended to be exhaustive.

68 Page 46, column 1.

95. In the House of Lords[69] the bank argued:

> (1) "… that where an employee assists in the violation by another of an individual's rights pursuant to a common design to that end, the employee incurs liability as a joint tortfeasor for the violation and his employer incurs vicarious liability for the violation if the assistance by the employee was in the course of his employment;"[70] and
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> (2) "… that the bank is entitled to succeed because Mr. Pillai's own acts of assistance were themselves tortious because they were carried out with the intention of bringing about a violation of the bank's rights." [71]

96. As to the first argument, Lord Woolf MR (with whom the other members of the House agreed) said this:

> "… before there can be vicarious liability, all the features of the wrong which are necessary to make the employee liable have to have occurred in the course of the employment. Otherwise there is no liability. You cannot therefore combine the actions of Mr. Pillai in the course of his employment with actions of Mr. Chong, which if done by Mr. Pillai would be outside the course of Mr. Pillai's employment, and say E.C.G.D. is vicariously liable for the consequence of Mr. Pillai's and Mr. Chong's combined conduct." [72]

97. In the course of rejecting the bank's second argument and holding that there was no such tort, Lord Woolf said this:

> "When this case was before the Court of Appeal, leading Counsel then appearing on behalf of the bank strongly relied on there being a relationship between accessories for the purposes of the criminal law and tortious liability for the purposes of the civil law. It was submitted that knowingly to facilitate the commission of crime amounted to the crime of aiding and abetting and should therefore also amount to a

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69 [1999] 2 WLR 540.
70 Page 545G to H.
71 Page 546A.
72 Page 547E.

> tort. This argument was rejected by the Court of Appeal. Before their Lordships the argument has not focused to the same extent on the alleged relationship between the criminal law and the law of tort. In my judgment to seek to draw analogy between the criminal and civil law in this area is unhelpful. The criminal law historically developed separately. The development of the criminal law was influenced by the distinction between felonies and misdemeanours. In order to determine whether there is any separate tort as Mr. Sumption contends, it is not necessary to answer the question as to whether Mr. Pillai could have been convicted of a criminal offence.
>
> The answer to Mr. Sumption's submissions is independent of the position under the criminal law. The tort upon which he seeks to rely is unsupported by authority. The authority which does exist strongly suggests that there is no such tort."[73]

98. It would be difficult to say more clearly that the rules for attribution in the civil law are different from those in the criminal law and that reference to the criminal authorities is not useful.

The Standard Chartered Bank case

99. In *Standard Chartered Bank v. Pakistan National Shipping Corporation* [2000] 1 Ll.R. 218 (CA) the Court of Appeal concluded that the managing director of a company, because he was acting in no other capacity than as a director, was not personally liable for a fraud he committed for the benefit of the company.

100. The relevant facts of the case were these. Oakprime, a company, sold two shipments of bitumen to Vietnamese buyers. Standard Chartered Bank confirmed a letter of credit opened in favour of Oakprime by the buyer's bank payable against documents showing shipment not later than 25 October 1993. Loading was in fact not completed until early December. So Mr. Mehra, the managing director of Oakprime, arranged with the shipowners and shipbrokers that bills of lading should be issued falsely dated 25 October 1993, and also arranged for other documents containing falsehoods to be created, so that Oakprime could draw down the credit. Mr. Mehra himself sent the bills and other documents to the bank, knowing them to be false, under cover of a letter signed by him on behalf of Oakprime which impliedly represented that the contents of the bills were true and accurate. Standard Chartered paid. The case is complicated by the fact that Standard Chartered allowed Oakprime to draw down on the letter of credit out of time, and against what were on any view non-conforming documents (even ignoring the falsehoods, which were of course unknown to the bank); and then itself tried to mislead the issuing bank as

[73] Page 551C to E.

to when the documents had been presented, and concealed the fact that discrepancies in those documents had been noticed but ignored. Oakprime went into liquidation, and the question arose whether Standard Chartered Bank had a good cause of action against Mr. Mehra.

101. The principal judgment on this point was delivered by Aldous LJ; and he identified three grounds on which Mr. Mehra might be liable:

> "First, if a director or an employee himself commits the tort he will be liable. An example is the lorry driver who is involved in an accident in the course of his employment. …
>
> The second way that a director or an employee will become liable is a branch of the first. A director or an employee may, when carrying out his duties for the company, assume a personal liability. An example where personal liability was assumed was *Fairline Shipping Corporation v. Adamson* ….
>
> The third ground of liability arises when the director does not carry out the tortious act himself nor does he assume liability for it, but he procures and induces another, the company, to commit the tort." [74]

102. Aldous LJ then went on to hold the following:

(a) As to the first ground:

> "Although Mr. Mehra was the person who was responsible for making the misrepresentations, he did not commit the deceit himself. For reasons I have already stated, the representations were made by Oakprime and not by him. Further, SCB relied upon them as representations by Oakprime and not as representations by Mr. Mehra."[75]

As we understand it, the reference to reasons already stated is a reference to this passage:

> "Lord Justice Evans has referred to documents relied on as containing the misrepresentations. They are all on Oakprime headed paper or clearly stated to be from Oakprime. Mr.

[74] At 233, column 2; and page 235, column 1.
[75] Page 233, column 2.

> Mehra's name appears as the person signing the documents as managing director of or on behalf of Oakprime. In my view the representations were made by Oakprime and all the evidence points to the conclusion that SCB relied upon them as being representations by Oakprime."[76]

(b) As to the second ground:

> "In the present case, Mr. Mehra, by his actions or statements never led SCB to believe he was assuming personal responsibility for the misrepresentations. SCB believed they were dealing with Oakprime. It follows that Mr. Mehra cannot be held liable on this ground."[77]

(c) As to the third ground (which was the basis on which the trial judge found Mr. Mehra liable), he held that this had not been pleaded and that an amendment should not be allowed.[78]

103. With the greatest respect to Aldous LJ, there are, we believe, two serious errors in this analysis. First, this is a case of civil fraud. Thus the liability of Oakprime rests, not on whether the company can be identified with the wrongdoer (as may well be required for criminal responsibility[79]), but on whether the company is legally responsible for what has been done by the wrongdoer: that in turn depends on whether he was an employee or agent of the company who committed the fraud while acting in the scope of his actual or apparent authority from it. Oakprime's civil liability for the fraud was vicarious. Mr. Mehra deliberately made a false representation to the bank to induce it to make a payment and, as a result, it did make the payment. In short he did commit the deceit himself, albeit in the name of and for the benefit of the company.[80] Mr. Mehra lied as an agent in the course of his agency. He therefore committed a tort for which he was personally liable and for which Oakprime was vicariously liable. This was not the breach of a duty of care owed by the company to the bank; it was a fraudulent representation by Mr. Mehra to the bank. The position is the same as if Mr. Mehra had been the agent of an individual who owned the bitumen business.

104. Moreover if Aldous LJ is right, fraudsters could escape liability easily by always telling their lies on behalf of £100 companies that they owned and controlled.[81]

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76 Page 233, column 1.

77 Page 235, column 1.

78 Page 235, column 2 to page 236, column 1.

79 See, for example, *Tesco v Nattrass* [1972] AC 153. See in particular per Lord Reid at 170 D to G.

80 Just like the bank manager in *Barwick v. English Joint Stock Bank* (1867) LR 2 Ex 259.

81 Provided the company was not formed for the purpose of committing fraud: see *Rainham* per Lord Buckmaster at 477.

105. Secondly, Aldous LJ's third ground of liability (that is the *Rainham* to *Spritebrand* line of authority) is not so much concerned with procuring *the company* to do something tortious, as with procuring another employee or agent of the company to do something

tortious for which the company will be liable. The director would himself be liable if sufficiently implicated in the tort. The only employee or agent of Oakprime who acted fraudulently on its behalf was Mr. Mehra himself (with the aid of the shipowners and shipbrokers).

106. Similar criticisms can, with respect, be made of the judgment of Evans LJ. where he said this:

> "The representations giving rise to liability in deceit were made by the company, notwithstanding that they were contained in letters signed by Mr. Mehra on behalf of the company or that they arose from his conduct in presenting the documents on behalf of the company, as he did. Even when the director makes the false statement, and a requisite knowledge of its falsity and the intention that it shall be acted upon are both his, nevertheless the fact remains that for the purposes of civil liability (the position in criminal law may be different) the statement is attributed to the company. The question then arises whether in such a case the director is free from personal liability.
>
> This is the converse of vicarious liability. The question is whether the director may be held liable for the company's tort. The mere fact that he is a director at material time does not suffice, but he may be personally liable when he ordered or procured the acts of the other persons which render the company liable: *C. Evans Ltd v. Spritebrand Ltd* … quoted by Lord Justice Aldous."[82]

107. Pausing there, we make the same point as above. It does not follow from the fact that Mr. Mehra's misrepresentations are to be attributed to the company, in the sense that it is liable for them because Mr. Mehra made them within the scope of his agency, that Mr. Mehra himself did not commit the tort of deceit. The bank was able to prove all the elements of the tort against him personally.

108. The judgment continues:

> "It can well be argued that, if the director is liable when he orders or procures acts on behalf of the company by others of its agents or employees, then manifestly he must be liable

[82] Page 230, column 2.

> when he commits those acts on behalf of the company himself.
>
> If this is correct, however, it becomes necessary to consider why the same principle was not applied so as to render the director liable in *Williams v. Natural Life Health Foods Ltd* [1998] 1 WLR 830. The House of Lords held that the relationship necessary to found a claim in negligence had existed only between the plaintiffs and the company defendant. The director was a stranger to that relationship (per Lord Steyn at p. 838H, rejecting a submission that the director and the company could be regarded as joint tortfeasors). The decision was concerned with the question whether the director owed a duty of care to the plaintiffs in the circumstances of that case. It appears to exclude, however, any suggestion that the director is necessarily personally liable whenever his acts are sufficient to make the company liable in tort.
>
> The judge applied the principles stated in Clerk & Lindsell on Torts (17th ed) par. 4.49 and *C. Evans Ltd v. Spritebrand.* He referred also to *Williams* but his judgment was given before the Court of Appeal's majority judgment was reversed by the House of Lords, on Apr. 30, 1998. The House of Lords' judgment is based on the pre-eminence given to the separate legal personality of the company: see the commentary by Ross Grantham and Charles Rickett Director's Tortious Liability: Contract Tort or Company Law? (1999) 62 MLR 133. It is thus necessary, in my view, to apply the principles of tortious liability strictly in accordance with this rule of company law."[83]

109. For the reasons we have already given we believe this is a misreading of *Williams*. Mr. Mistlin was not liable because he had not assumed responsibility towards the plaintiffs; only the company had assumed responsibility and assumption of responsibility is an essential ingredient of the tort. So only the company could be in breach of duty and be liable in tort. But for Mr. Mehra to tell lies to the bank and so cause it loss was a tort by him whether he was acting for someone else or not. Everyone has a duty not to commit fraud. On the reasoning of Evans and Aldous LJJ it seems that the dishonest managing clerk in *Lloyd v. Grace, Smith & Co* was not personally liable for his fraud because, so far as the victim was concerned, she was dealing through him only with the firm. But the whole basis of that decision was that, for acts done within the scope of a man's agency,

[83] Page 230, column 1 to page 231, column 2.

"the principal is thus liable for the torts and negligences of his agent…".[84] No-one doubted that the managing clerk had committed a tort.

110. With great respect, this part of the *Standard Chartered Bank* case is erroneous and will, we expect, be reversed should this point go to the House of Lords.

[84] Lord Macnaghten quoting Blackburn J in turn quoting *Story on Agency*, at 737.

AUDITORS

Introduction

111. Auditors are appointed to report to a company's members on its annual accounts, and have to state whether in their opinion those accounts have been prepared in accordance with the Companies Act and, in particular, whether the financial statements give a true and fair view of the state of affairs of the company at the end of the financial year, and of its profit or loss for that year. In preparing their report they have to carry out such investigations as will enable them to form an opinion as to whether proper accounting records have been kept by the company and whether the company's individual accounts are in agreement with those accounting records.[85]

112. Where a company's auditors fail to carry out their work competently this can lead to loss to the company. Trading losses or thefts may go undetected and thus continue unchecked; exposure to the risk of such losses and thefts as a result of poor records and controls may go unreported and thus unremedied. Financial statements that are false as a result of mistake or fraud may go uncorrected, and may lead to the making of unwarranted distributions.

113. In all these cases, however, the initial and primary responsibility for protecting the company against loss lies with the company's own employees and in particular with its directors.

114. The negligence of the auditors usually causes loss to the company where they fail to detect damaging conduct that is still going on and which, if discovered and reported, could and would be stopped; or by failing to discover that profits have been inflated or losses understated.

115. In reality, of course, such negligence may cause loss to other people besides the company. Traders may afford the company credit, banks may give or extend loans to the company and investors may buy or sell shares of the company on the strength of the company's audited accounts. As the law stands, in the ordinary way the auditors do not owe these people a duty of care and so their negligence will not give rise to liability.[86]

116. The Consultation Document, however, considers extending the range of the auditors' duty of care so that they owe a duty, "to those who may reasonably be expected to rely upon"[87] the information they have reviewed. In this context the Document goes on to address, at paragraphs 5.156 to 5.168, auditors' rights to limit their liability.

117. After rejecting the suggestion that there should be a statute making liability proportionate among all responsible for a wrong the Document says this, at paragraph 5.162-164:

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85 This is an abbreviated account of the duties set out sections 235 and 237 of the Companies Act 1985.

86 See *Caparo Industries plc v Dickman* [1990] 2 AC 605 (HL).

87 See paragraph 5.148.

> "… An alternative approach, which we are inclined to support, is to amend or clarify the law to ensure that the acts of employees and agents (including directors) are properly attributed to the company (which is normally the claimant), and so taken into account in any assessment of the damages to be paid by the auditors. Thus where directors or employees act fraudulently, negligently or in breach of their statutory duty, their acts would be imputed to the company and the liability of auditors to the company would be reduced to reflect this contributory fault. This would align the duties of directors and the rights of companies in a manner that would reflect their relationship, allocating losses efficiently between those who should have taken steps to reduce them and who stand to benefit from the activities of the company's agents. This would also address case where the claim is made by a person other than the company (or often its liquidator), since the auditor would be able to pursue the company for a contribution towards his liability."

118. A footnote to paragraph 5.162 says this:

> "As consequence of such a reform, the rights of a company would properly take account of the fact that directors, and employees, are the persons primarily responsible for the management of a company and a company would be unable to seek full compensation from others (e.g. the auditors) for the failures of the company's own officers. It would also mean that investors and creditors who seek to sue through a company could no longer distance themselves from the acts of those to whom they entrust the management of the company's affairs (as currently happens when claims are brought by liquidators in the name of the company concerned)."

119. The Document then continues:

> "5.163 However, as we indicated in Chapter 3, it is not clear that companies are vicariously liable for the negligence, fraud or breach of duty of their directors, and we believe that the law should make clear that they are. Even so, there will still be doubts as to whether auditors would be able to pursue claims for contribution or to raise defences of contributory negligence in such cases. While we are aware of no British case, the Australian courts have denied such claims by

> auditors on the grounds that the failure cannot be attributed by them to the company because it was the very failure from which they were obliged to protect the company. While we are inclined not to accept this view, implementing our approach would require the law to preclude the judges from following their Australian colleagues, which may be unattractive.
>
> 5.164 It is important to stress that even if the law on contributory negligence and contribution could be clarified in this way to bring home part of the responsibility for a company's officers' negligence and fraud to the company and its shareholders, this will not solve the problem in the majority of cases. Where the company is insolvent any action for a contribution from the company towards a liability to a third party will be of no value to the auditor (though contributory negligence will still be of value against the liquidator). We believe the only effective solution in such cases is contractual limitation of liability."

120. These passages raise acutely difficult questions of law as yet undecided in England. For although we are aware that in a number of cases auditors who have been sued by the company they audited, or by its liquidator have pleaded by way of defence contributory negligence based on the conduct of the company's directors, we know of no instance in which the issue has reached judgment in a reported English case.

Contributory negligence

121. The Law Reform (Contributory Negligence) Act 1945 ("the 1945 Act") provides, so far as material, as follows.

> "1(1) Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage: …
>
> 4…'fault' means negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence."

122. Where it applies, the 1945 Act operates to reduce a company's recovery if the court decides that there was "fault" by an employee or agent of the company which was causative of the damage complained of and which should be attributed to the company. Thus if a vehicle owned by the company is damaged in an accident caused by the negligence of a third party, but for which the negligence of the company's own employee driver was partially to blame, the damages recovered by the company will be reduced to reflect the extent of its driver's fault.

123. The specific question here is therefore this. Where a company suffers damage because of the negligence of its auditors in the conduct of their audit can the company's recovery be reduced if that damage is partly the fault of one or more of the company's own directors?[88] The answer to this question turns on whether the fault of the director or directors is to be attributed to the company as the company's "own fault".

124. Before seeking to answer this question, we must make three points about the 1945 Act. First, it must be remembered that although in its title it refers to "contributory negligence" (and that is the expression usually used by lawyers) a claimant's damages will fall to be reduced for want of sensible care on his part to protect himself which is causative of the damage he has suffered. The claimant does not have to be guilty of conduct which would, if done to another, constitute a tort. It is thus more accurate to speak of "contributory fault" on the part of the claimant.[89] Secondly, contributory negligence, like negligence itself, can include intentional conduct by the claimant that is causative of the damage he suffers.[90] Thirdly, in England the 1945 Act applies to reduce damages not only where the duty breached by the defendant arises in tort, but also where the duty breached by the defendant arises concurrently both in tort and in contract.[91]

Attribution

125. The question that Lord Hoffmann asks in *Meridian*, applied to contributory negligence, is: whose act or omission is, *for the purpose of deciding whether damage is the company's "own fault"*, intended to count as the act or omission of the company?

126. As can be seen from the example given above of the company vehicle damaged in an accident caused partly by the fault of a third party and partly by an employee acting in the course of his employment, the employee's fault will ordinarily be attributed to a

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88 For the purposes of this Advice we do not think it is necessary to consider all the possible permutations of what might constitute fault, whether on the part of directors or on the part of auditors. In the first place there is whatever is causing damage to the company. That may be the result of conduct that itself involves no breach of duty to the company on anyone's part, or may be the result of negligence or fraud. Secondly, questions may arise as to the adequacy of the records or systems of control at the company. Thirdly, the information given to the auditors may be wrong or incomplete because of negligence or fraud on the part of employees or directors of the company. Fourthly, the auditors themselves may be negligent either in failing to discover something that they should have discovered, or having discovered it, in failing to report it. However trite it may seem, it is important to realise that the outcome of any particular case will depend crucially on the permutations of facts in that case.

89 See *Commissioner of Police v Reeves* [1999] 3 WLR 363 (HL) per Lord Hope at 382C to F.

90 See *Reeves* op cit.

91 This is not the case in Australia: see paragraph 159 below.

company for the purposes of the 1945 Act in accordance with the principles of vicarious liability. But in some cases attribution might be made under the company's primary rules of attribution.[92] For example, if a company by the decision of its board of directors entered into a loss-making transaction on the negligent advice of independent valuers, those valuers could rely on the 1945 Act if the board's decision was a misjudgement that someone taking sensible care to protect his own interests would not have made.

127. In the case of claims against auditors, whether a director's acts or omissions will be attributed to the company is of great practical importance. Any claim for a contribution that the auditors may have against the director personally may be of little practical value if he has no assets or has left the jurisdiction. In any event, in order to succeed in a claim for contribution, the auditors must show that the director breached a duty to the company making him "liable in respect of the same damage"[93] as that in respect of which the auditors are also liable. This is a higher hurdle than showing that the director, without necessarily breaching any duty, behaved in a way that showed lack of reasonable prudence in safeguarding the company's interests.

128. When a company (or its liquidator) sues the company's auditors, in what circumstances is the act or omission of a director to be attributed to the company for the purposes of establishing contributory negligence on the part of the company? In other words, when does it constitute the company's "own fault"? The authorities suggest that there are three possible answers to this question. The first is never. The second is where the director has been guilty of contributory fault other than fraud on the company. The third is that the defence is available in the case of all forms of contributory fault by a director, including fraud on the company.

Never

129. The first answer has a respectable lineage. It seems to have been taken for granted in some of the late nineteenth and early twentieth-century English authorities in which contributory negligence appears simply not to have been pleaded by defendant auditors. It must, however, be borne in mind that prior to 1945 a successful plea of contributory negligence by auditors would have defeated the company's claim entirely as at that time contributory negligence constituted a complete defence.

130. The position on the English authorities up to at least 1945 appears to be that contributory negligence was not available to auditors: it is either not argued or it is held that it is no defence: *Leeds Estate Building and Investment Company v Shepherd* 36 Ch. D 787 (not argued), *Re London and General Bank (No.2)* [1895] 2 Ch. 673 (not argued), and *Re Kingston Cotton Mill Company* [1896] 1 Ch. 6 (not argued).

131. In *London Oil Storage Limited v Seear, Hasluck and Co.* (1904) 31 Accts LR 1, Lord Alverstone CJ summed up the law to the jury as follows:

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92 See paragraphs 23 to 25 above.

93 See section 1(1) Civil Liability (Contribution) Act 1978, quoted in full at paragraph 210 below.

> "I entirely agree with the view of the law explained to you by Mr Bankes [the plaintiff's counsel], that the auditor cannot shelter himself for any breach of duty under the neglect of the directors; he is there to do his duty to the company; the only point on which the conduct of the directors may become material is upon the subordinate question as to whether there is anything to arouse the suspicion of the auditor, and whether or not the loss has really been occasioned by the auditor's conduct."[94]

132. Of the post-1945 authorities, contributory negligence was not argued in *Re Thomas Gerrard & Son Limited* [1968] 1 Ch. 455. Two post-1945 cases where it was argued, *De Meza and Stuart v Apple* [1974] 1 Ll. Rep. 508 and *Henderson v Merrett Syndicates Ltd (No. 2)* [1996] LRLR 265, are discussed below.

133. There is recent House of Lords support in *Reeves v Commissioner of Police for the Metropolis* [1999] 3 WLR 363 for the view that pre-1945 decisions on contributory negligence are to be read carefully in the light of the policy considerations in play when all-or-nothing decisions had to be made. Lord Hoffmann said of a 1942 decision under the Factories Acts in which the Court had been "exceedingly chary of finding contributory negligence where the contributory negligence alleged was the very thing which the statutory duty of the employer was designed to prevent"[95], that it was not surprising that judges gave priority to the legislative policy of the Factories Acts even if, in practice, it meant not applying or overriding the common law defence of contributory negligence.[96]

134. A succinct justification for the answer "never" is given by Moffitt P in *Simonius Vischer & Co v Holt & Thompson* [1979] 2 NSWLR 322[97]:

> "Where the action for professional negligence is against an auditor, it is difficult to see how a finding of contributory negligence, according to usual concepts, could be made. If, as where the audit is of a public company, the audit contract or the undertaking of an audit is found to impose a duty to be exercised so as to safeguard the interests of shareholders, it is difficult to see how the conduct of any servant or director could constitute the relevant negligence, so as to defeat the claim against the auditor, whose duty is to check the conduct

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94 Page 1, column 2.

95 The decision was *Hutchinson v London and North Eastern Railway Co.* [1942] 1 K.B. 481 at 488, speech of Goddard L.J. cited in *Reeves* at 370H.

96 Pages 370H to 371A.

97 This passage is referred to in a number of subsequent decisions including *Daniels* (at 565 and 566) and *Dairy Containers* (at 76).

> of such persons and, where appropriate, report it to the shareholders."[98]

This amounts to a more fully reasoned statement of the position taken by Lord Alverstone CJ in *London Oil Storage*.

135. Thus, it is argued that a claimant company cannot be guilty of contributory fault where the defendant auditor owes a duty (whether in contract or tort) to protect the company from the very loss or damage for which the auditors seek to blame the directors.

136. A second possible argument in support of this answer is that, as the duty to prepare the accounts that are audited and the duty to prepare a directors' report are ones imposed upon the directors, and not the company[99], if the directors are guilty of fault in the course of carrying out those duties, that fault cannot be attributed to the company.

137. A third reason that, we understand, has been advanced in argument is that because conduct that would otherwise constitute contributory negligence by a company was not recognised as a defence available to auditors prior to the entry into force of the 1945 Act, such conduct does not constitute "fault", as defined in section 4 of that Act. In short it is suggested that such conduct is not some "other act or omission which … would, apart from this Act, give rise to the defence of contributory negligence"[100].

138. The first reason is addressed and rejected in the authorities to which we refer below. Moreover, in our view, the argument that the defence of contributory fault should not be available to a defendant in breach of a duty to protect the claimant against the very damage for which he seeks to blame the claimant is seriously undermined by the decision of the House of Lords in *Reeves*. In that case it was held that damages against the police for the death of a prisoner who committed suicide in custody fell to be reduced by reason of his contributory fault despite the fact that the police were under a duty to take reasonable care of his safety while in custody.

139. The second argument would not in our view prevent a finding of contributory fault by the company. If the directors are acting within the scope of their employment or agency for the company when preparing the company's accounts and their report, as we think they must be, then the fact that "fault" on their part is, or may be, the breach of a duty owed by them personally and not by the company would not prevent the company being vicariously liable for that fault if it constituted a tort[101] as in the case of an employee's negligent driving in the course of his employment. And for the reasons discussed below we think that, generally, if the company would be vicariously liable for the directors' fault if tortious then such fault is attributable to the company for the purposes of the 1945 Act.

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98 Pages 329G to 330A.

99 See sections 226(1), 227(1) and 234(1) CA 1985 as amended. See also sections 235(1) and (3) CA 1985.

100 Section 4.

101 See the discussion in *Clerk & Lindsell on Torts* at paragraphs 5-44 and 5-45.

140. As to the third, historical, argument we do not believe that has any validity. What acts or omissions would, "apart from this Act", give rise to the defence of contributory negligence are not to be identified by legal archaeology, but by the application of legal principle. Moreover, as is pointed out in some of the Australian cases referred to below when construing almost identical legislation, there is no suggestion in the statutory language that auditors are somehow in a special category and unable to rely on fault on the part of a claimant company.

Contributory fault other than fraud on the company

141. The question whether auditors can rely on the fault of directors as the contributory fault of the company has been much discussed in United States, Canadian, Australian and New Zealand cases: in the case of the United States, sometimes in jurisdictions where contributory negligence is still a complete defence and sometimes in jurisdictions, where, as here, there is apportionment. Before considering what approach an English court might take, it is the recent Australian and New Zealand authorities that require close attention. There a clear consensus has developed that auditors are entitled to set up against the company the fault of directors where that fault does not involve fraud against the company.

142. In *Dairy Containers Limited v NZI Bank Limited* [1995] 2 NZLR 30, the company (DCL) was the victim of a substantial fraud by three senior employees. The directors had been at fault as regards their responsibility to manage the company[102] and the auditors had been negligent in the conduct of their audits[103]. If the auditors had not been negligent, the frauds would to a large extent have been deterred or would have been exposed earlier. The auditors pleaded that the contributory negligence of the directors (and of the employees[104]) should reduce the damages payable. Although it had been argued on behalf of DCL that the plea of contributory negligence was not open to the auditors at all, counsel for DCL eventually accepted that it was available in principle.

143. However, he invited the Court to take a narrow approach to the application of the relevant legislation (which was in all material terms identical to the 1945 Act). Thomas J agreed that the directors' want of care should count as the company's contributory negligence, but preferred a broad approach.

> "Two conflicting views, each with its own stream of authority, compete for the favour of the Courts where an auditor has raised the defence of contributory negligence. On one view, contributory negligence is to be confined to acts of the company which have interfered with the performance of the audit. In other words, contributory negligence is a defence only where the negligence contributed to the auditor's failure to carry out his or her

102 See pages 79 to 83.

103 And in relation to certain other work that they had agreed to perform.

104 See below for the discussion of the claim in relation to the employees, which in substance relied on their fraud.

> contract and report on the truth and fairness of the accounts. On the other view, the company may be contributorily negligent where it has failed to look after its own interests, even though it may not have prevented or hindered the auditor from carrying out his or her duties. It is this broad approach which the Auditor-General wishes me to endorse.
>
> The broader approach appeals to me. I am not certain, however, that it is necessary for me explicitly to adopt that approach. It might fairly be said that in each of the respects in which I propose to hold that DCL is guilty of contributory negligence, the Auditor-General's ability to conduct a proper audit was so impaired as to amount to interference on the company's part. Indeed, it is arguable, that where the management of a company is seriously defective, as in this case, the defect must necessarily affect the auditor's ability to perform the audit and report the truth. The auditor is still required to exercise reasonable care, of course, but if he or she fails to do so that does not mean that the company's gross laxity will not have contributed to that failure. If the more restricted viewpoint were to prevail, I would be prepared to carve out an exception to this effect.
>
> Neither seeking to bring the scope of DCL's negligence within the restrictive approach nor spelling out an exception, however, meet the requirements of this case as aptly as the broader approach for which Mr Camp contends. In essence, that is the approach which I have adopted, and it is therefore appropriate that I shortly state my reasons for preferring it."[105]

144. Thomas J then referred to twin streams of authority in Australia, Canada and the United States and continued:

> "For myself, I am not prepared to exempt the defendant from the general law simply because he or she is an auditor. There is no need to formulate a special rule. **The difficulties which have led many Judges to restrict the defence of contributory negligence when raised by an auditor can be readily accommodated in the exercise of apportioning responsibility.** Having regard to those factors may, in many cases, result in a nil or negligible assessment of contributory liability, but that does not mean that the defence cannot apply or must be restrictively applied so as to inhibit a fair

[105] Page 74, line 47 to 75, line 16.

and equitable result consonant with the responsibility of the parties in contributing to the loss."[106] (Emphasis added)

145. The Judge then considered the opposing argument as articulated by Moffitt P in the passage in *Simonius Vischer* cited at paragraph 134 above and continued:

> "As strong as this point may be on the facts of a particular case, I do not consider that it justifies a total prohibition of contributory negligence or the restriction of that doctrine to cases where the company directly interferes in the conduct of the audit. Setting aside the wisdom which an analysis of the case law would bring, there are two main reasons why I take this view.
>
> First, there can be no sound reason why the wording of the Contributory Negligence Act should be read restrictively. The section applies where a person suffers damage partly as the result of his or her own fault and partly the fault of another person. Where these circumstances exist, the damages are to be reduced to such extent as the Court thinks just and equitable having regard to the plaintiff's share in the responsibility for the damage. It is important to note that the apportionment is to relate to the *damage*, and is to reflect the plaintiff's share of the responsibility for that *damage*, and not to the negligent activity of the two parties. On the facts of this case, I do not believe I could arrive at an apportionment which was 'just and equitable' if I were to adopt the narrower approach. [emphasis in the original]
>
> Secondly, I consider that the restrictive view is incompatible with the contemporary approach to contributory negligence and the apportionment of loss. Difficult though the exercise may at times be, the Act requires a Court to recognise the plaintiff's failure to meet the standard of care required of it for its own protection where that failure is partly the cause of the loss. It is an attempt to ensure that liability coincides with the responsibility of the parties for the damages in issue ….
>
> The Contributory Negligence Act was enacted to remedy the arbitrary consequences of the all-or-nothing approach which developed where the plaintiff was in part responsible for the loss which he or she suffered. It is now inappropriate to approach the application of the Act in a manner which would perpetuate arbitrary consequences, although less dramatic, of

[106] Page 75, line 44 to 52.

> the kind which the Act was designed to remedy. It is for the Courts, in implementing the Act, to fashion a regime under the Act which is fair and efficient in apportioning responsibility for the loss to where it rightly belongs.
>
> In the context of this case there is no merit in providing DCL with immunity from the consequences of its negligence where that negligence has clearly contributed to cause the loss simply because the Auditor-General was also negligent. One can paraphrase Rogers CJ's question, posed in a different context, in *AWA v Daniels* (at p 1,003) and ask why the negligent auditor should be exposed to the payment of the whole of the loss when much of the damage lies as the door of the company? The answer is clear. It would be wrong in principle if the Auditor-General could be sued for failing to report the unauthorised investments and detect the frauds which occurred and yet not be able to rely upon DCL's own acts which permitted the unauthorised investments and frauds to occur in the first place." [107]

146. The discussion[108] of the precise apportionment that the Court made on the facts shows that considerations of the scope of the danger from which the auditors were supposed to protect the company are a significant part of a court's consideration and show a careful balancing both of the respective blameworthiness of the two parties and the causative potency of their acts in causing the damage. On the facts, DCL's damages were reduced by 40 per cent.

147. In *Daniels v. Anderson* [1995] 37 NSWLR 438 (New South Wales Court of Appeal) a company ("AWA") employed a foreign exchange manager ("K") to buy foreign currency forward against actual or anticipated contracts to purchase goods abroad. Between 1985 and 1986 K lost A$49.8 million. K was able to do this undetected because there were gross deficiencies in the company's records and internal controls which had not been reported to the board by the auditors (Deloittes). AWA sued Deloittes for breach of contract and negligence. Deloittes claimed the loss had been caused, or contributed to, by the company's own fault, which consisted of a failure to have an adequate system of supervision and controls and a failure to act on advice, information and warnings received.[109] Deloittes also claimed an indemnity or contribution from four directors (one executive and three non-executive), saying that they were liable in tort for the same damage suffered by AWA as that for which Deloittes themselves were liable.

148. The Court of Appeal acquitted the non-executive directors of negligence[110], but found that the executive director had been negligent[111]. The Court of Appeal also held

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107 Page 76 , lines 13 to 56.
108 Pages 82 to 83.
109 See pages 487 to 488.
110 Page 514.
111 Page 524.

that had the auditors behaved competently, A$6 million of the loss would have been prevented.

149. In relation to contributory negligence, Clarke JA and Sheller JA said this.

> "AWA submitted that, having regard to the particular position in which the auditors stand in relation to the company to which they are appointed auditors, there is no room for the operation of the doctrine of contributory negligence. We consider that this proposition is too widely stated to be acceptable. Nonetheless, it is necessary to consider its general thrust and that is that in the circumstances of this case Deloitte Haskins & Sells should be held liable for all the damage either because they were the cause of the ultimate losses suffered by AWA or because any negligence of employees of AWA should not be imputed to it.
>
> Before considering the detail of the submissions it is necessary to make a number of relevant observations. First, while there appears to have been some discussion at the trial of the role of contributory negligence in an action based, inter alia, on breach of contract that question was not adverted to in this Court. On the contrary the argument proceeded on the basis that it did not matter whether AWA's action was viewed as an action in tort or for breach of contract.
>
> Secondly, contributory negligence is no longer a defence to an action in tort (as this case has been treated). In the event that a Court finds that a Plaintiff has been guilty of contributory negligence (more accurately, causative fault) it is required to embark on a consideration of the question whether the plaintiff's damages should be reduced.
>
> This is not unimportant for some of the authorities relied on by AWA, and particularly the American authorities, speak of contributory negligence *defeating* the claim or relieving the auditors of the responsibility flowing from their breaches of duty [emphasis in the original]. The changes effected by the apportionment legislation ameliorated the consequences flowing from the absolute common law doctrine and led, effectively, to the abandonment by the courts of what Professor Fleming has described as judicial palliatives, most notoriously the 'last opportunity rule': Fleming, *The Law of Tort* 8th ed (1992), at 270.

> It is with these observations in mind that we turn to consider AWA's submissions."[112]

150. Their Honours then set out Section 10 of the Law Reform (Miscellaneous Provisions) Act 1965 which, so far as is material, largely duplicates section 1 of the English Law Reform (Contributory Negligence) Act 1945[113]. They then continued:

> "Section 10 requires an enquiry into the fault of the plaintiff and, upon findings that such fault existed and that it was causative of the damage, a determination on apportionment based on what is just and equitable in the circumstances. Its terms do not, in our view, support the proposition that, notwithstanding a finding of fault on the part of the plaintiff, there should as a matter of law, be no apportionment where the defendant is the plaintiff's auditor. Nonetheless there are statements in some of the authorities which appear to support the propositions now being advanced. Before referring to those authorities we should point out that the cornerstone of the argument is the auditor's function of safeguarding the interests of shareholders and, for that purpose, checking on directors and, through them, on management. Where, so the argument runs, the auditors become aware of weaknesses in the systems of books and records and internal controls and of activities of management upon which they are obliged to report, they cannot seek to exclude or limit their liability by reference to the very matters which activated the duty imposed upon them.
>
> Perhaps the strongest support for the submission is to be found in the obiter dictum of Moffitt P in *Simonius Vischer & Co v Holt & Thompson* [which they quote; this is the passage quoted at paragraph 134 above].
>
> This dictum was applied in *Arthur Young & Co v WA Chip & Pulp Co Pty Ltd* [1989] WAR 100 at 104 and *Walker v Hungerfords* (1987) 44 SASR 532 at 554; 49 SASR 93 at 95, but in the context of the consideration of either the question of whether the acts of a particular person, or particular persons, could be imputed to the plaintiff and lead to a finding of contributory negligence against it or the question whether the conduct in question constituted, as a matter of fact, contributory negligence. Neither court propounded a legal principle that contributory negligence could not be found in an auditor's favour. Each referred to the

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112 Pages 564D to 565C.

113 The definition of "fault" is different in the two Acts as under the English Act fault includes breach of statutory duty whereas the New South Wales Act excludes it.

considerations mentioned by Moffitt P in determining purely factual questions. The submission was advanced that until this case there had been no decision to the contrary of Moffitt P's dictum in the Courts of this country. That may be so but, except in so far as judges have applied the obiter dictum of Moffitt P. in determining factual questions, there has not been a consideration of the precise point presently engaging the Court and it should not be overlooked that Moffitt P was not dealing with the point."[114]

151. Their Honours then dealt with the first instance judgment of Rogers CJ and the American and Canadian authorities that he considered. They then continued:

> "We do not, with respect, derive any assistance from these authorities. There is no reference to accountants and auditors in s 10. They are not singled out and placed in a particular category. In these circumstances there is no basis for a legal rule disentitling auditors from claiming that their clients are guilty of default.
>
> To the extent that any of the cases on which AWA relies suggests that there is such a legal rule (and neither the Australian, New Zealand or Canadian cases make such a suggestion) we are not prepared, or able, to apply them. It may be argued, for instance, that policy considerations led to the adoption of a 'legal' rule in *National Surety Corporation v. Lybrand* and *Shapiro*. The policy that this Court is obliged to apply is found in s 10 and on no reading of that section could it be said that there is implied an exception concerning auditors.
>
> In our opinion the answer to the problem is dictated by the terms of the statute. The Court is required to conduct an inquiry to determine whether the plaintiff has been guilty of negligence and if so, whether that negligence has contributed to the loss which has been suffered by it. Once affirmative advances have been given to both of those questions then the court is required to carry out a just and equitable apportionment.
>
> To put it slightly differently, s10(1) of the *Law Reform (Miscellaneous Provisions) Act* 1965 operates upon a finding of fault in a defendant. It requires a Court to carry out a factual enquiry whether the damage suffered by the plaintiff resulted partly from that fault on the part of the defendant

[114] Pages 565D to 566C.

and partly the plaintiff's own fault. In so far as a finding of causative fault on the part of the plaintiff is necessary before questions of apportionment arise under s 10(1) the section directs attention initially at two factual questions. First, whether the plaintiff was guilty of fault and, secondly, if so whether that fault was a cause of the damage which it suffered. In the event that the Court determines the question of fault and causation against a plaintiff it is required to reduce the damages payable to it to such extent as it thinks 'just and equitable' having regard to the claimant's share of the responsibility for the damage.

The first two inquiries are purely factual ones and the third involves the exercise of a judicial discretion requiring a consideration of causation and culpability. …

Leaving aside the question whether all the defaults of management ought to be imputed to AWA, it is clear that a consideration of the first question requires an examination of the conduct of the directors and employees of the company in order to determine whether a finding should be made that AWA was, relevantly, negligent. Once it has been decided that negligence has been established on the part of AWA then it is necessary to determine whether that negligence was the cause of the loss suffered by it.

It is not difficult to understand the importance of the role of an auditor in the consideration of the two questions, that is, whether the plaintiff was negligent and, if so, whether that negligence was a cause of its loss. In some cases, *Arthur Young & Co* was one, the duties of the auditor were treated as relevant to a determination whether the failing of a member of the plaintiff's staff should be treated as negligence on the part of the plaintiff. In others the particular role of the auditor may loom large on the issue of negligence and the determination of the causation issue. In all instances the Court considers whether, as a matter of fact, the plaintiff was negligent and, if so, whether its fault was causative of the loss.

The role of the auditor may have other significance. It will, almost certainly, be relevant in considering questions of apportionment and it may be appropriate, in particular circumstances, to make a finding that it is just and equitable that, for instance, the auditor bear all the damages despite the fault of the client.

> These observations emphasise the point that once an auditor seeks a reduction of damages pursuant to s 10 a number of questions arise, all of which are factual questions (although legal principles, such as those relating to causation, are applied in reaching the appropriate conclusion). The diversity of circumstances in which an auditor may seek to rely on s 10 denies, in our view, the validity of the alternative proposition put by AWA to the effect that, as a matter of fact, contributory negligence is not available to an auditor.
>
> Where, as in the American cases, an employee steals money from his employer and the auditor negligently fails to detect and report upon that fact it may be difficult to establish a case for the reduction of the damages. On the other hand where the directors and management of a corporation are guilty of fault (we are speaking hypothetically) both before and after an auditor's negligent acts and omissions and their fault materially contributes to the damage suffered it is difficult to contend that the auditor cannot rely on that fault. In each case the question must be one of fact to be decided on all the circumstances of the case and without the intrusion of any supposed factual presumptions. For these reasons we would reject AWA's primary submission that Deloitte Haskins & Sells could not secure a reduction of damages pursuant to s10."[115]

152. Up to this point, their Honours have dealt with the case on the footing that once it is decided that the statute does not exclude auditors, whether the damages should be reduced is entirely a question of fact and discretion. The question of attribution is side-stepped by the words "leaving aside" etc. That, however, has the effect of dealing with attribution as something of an afterthought, as indeed, it seems to have been treated in argument:

> "Mr. Bathurst put an alternative argument to the effect that his Honour should not have held that the acts of management, which he characterised as contributory negligence, should be treated as acts of the company. Mr. Bathurst pointed out that his Honour reached this conclusion on the basis of his finding that so far as the foreign exchange operations were concerned the members of senior management were in day-to-day charge of the operations and therefore their acts were the acts of the company.

[115] Pages 567B to 568F.

> He submitted that for the acts of senior management to be attributed to the company it would be necessary to show that the board had delegated the particular functions concerned, giving management full discretion to act independently of instructions, and he submitted that in the present case there was no evidence that this occurred."[116]

153. Mr Bathurst was submitting that only the fault of someone who embodied the company could be constitute contributory fault and relied on *Tesco v. Nattrass*. Their Honours, however, observed:

> "Lord Reid was not, however, concerned with tort principles, and in particular those concerning contributory negligence, and the assumption made by Counsel is not, in our opinion, soundly based. Although we acknowledge the limited consideration by the courts of the question now being discussed the text writers almost universally support the proposition that the relevant principle is one of identification or imputation. Subject to possible exceptions which are not relevant in this case in which the senior management was negligent, the principal is identified with the wrongdoer in those cases in respect of which it would be held vicariously liable to a third party for the acts of that wrongdoer: see *Charlesworth & Percy on Negligence*, 8th ed (1990) at 3.33 § 195: In *Salmond & Heuston on The Law of Torts,* 20th ed (1982), at 511, it is said: 'The contributory negligence of the servant of the plaintiff is a good defence, in the same cases and to the same extent as that of the plaintiff himself, whenever the plaintiff would have been responsible for that negligence of his servant had harm ensued from it'; see also G. Williams *Joint Torts & Contributory Negligence* (1951) at 115, *Winfield & Jolowicz on Tort*, 14th ed. 1994 at 184. In Atiyah on *Vicarious Liability in the Law of Torts* (1967) at 409, the author stated the same principle but he did so in terms which indicated his lack of confidence in the proposition. He said:
>
> > 'The answer seems to be that the plaintiff is identified with the negligence of A in any circumstances in which the plaintiff would himself have been liable for A's negligence (whether vicariously or otherwise) had that negligence caused damage to another party who claimed for it against the plaintiff. This proposition is put forward with some diffidence

[116] Pages 568F to 569A.

> because the question has rarely been considered in the courts in England, and also because the policy considerations which demand that one person may be held responsible as defendant for the negligence of another do not necessarily apply where it is sought to render one person responsible for the negligence of another by way of contributory negligence where he is plaintiff.'
>
> While we cannot deny that difficulties may arise in the universal application of that principle, we do not see any reason why the principle stated in the texts should not be applied in this case in which the claim is that the company itself (through its board and chief executive) and persons for whom the company is vicariously liable were negligent.
>
> The second reason why the submission should be rejected is that the trial judge's findings that the directors delegated the task of setting-up and operating the foreign exchange operation, almost wholly, to management leads us to conclude that, subject to what follows later, management should be equated with the company. It follows that we agree with the trial judge that a finding of contributory negligence was open and should be made."[117]

154. Later on, their Honours also said:

> "In considering whether a company has failed to take reasonable care for its own protection the court is not concerned with degrees of knowledge of the individual directors, except, perhaps, in an incidental way. It is solely concerned to determine whether the company failed to take reasonable care for its own welfare -- and in considering that question the court will have regard to the acts and omissions of the directing mind of the company and, in general, of those persons for whose acts and omissions it is vicariously liable."[118]

155. The Court went on to hold that damages should be reduced by one third on account of AWA's negligence.

156. *Daniels* therefore decided that, in relation to the New South Wales statute:

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117 Pages 569G to 570E.

118 Page 575A to B.

(a) auditors are entitled to rely on a defence of contributory negligence against the company whose accounts they audit; and

(b) generally speaking, the claimant will have attributed to him the fault of another person where the claimant would be liable for it, whether vicariously or otherwise, if it caused damage to a third party.

157. *Astley v Austrust* [1995] CLR 1 (High Court of Australia) concerned negligent lawyers rather than auditors. In advising on a proposed trust deed for a trading trust, the lawyers had failed to advise a trustee company that it could become personally liable to creditors of the trust and that it would be desirable to insert a provision in the deed to avoid this eventuality. The directors of the defendant trustee company had been, it was argued, contributorily negligent in failing to inquire as to the soundness of the underlying business venture and in particular whether its assets could, if necessary, repay the loans which had been taken out.

158. The High Court of Australia, approving *Daniels*[119], held unanimously that there was:

> "no rule that apportionment legislation does not operate in respect of the contributory negligence of a plaintiff where the defendant, in breach of its duty, has failed to protect the plaintiff from damage in respect of the very event which gave rise to the defendant's employment. A plaintiff may be guilty of contributory negligence, therefore, even if the 'very purpose' of the duty owed by the defendant is to protect the plaintiff's property. Thus, a plaintiff who carelessly leaves valuables lying about may be guilty of contributory negligence, calling for apportionment of loss, even if the defendant was employed to protect the plaintiff's valuables.
>
> A finding of contributory negligence turns on a factual investigation of whether the plaintiff contributed to his or her own loss by failing to take reasonable care of his or her person or property. What is reasonable care depends on the circumstances of the case. In many cases, it may be proper for a plaintiff to rely on the defendant to perform its duty …. But there is no absolute rule. The duties and responsibilities of the defendant are a variable factor in determining whether contributory negligence exists and, if so, to what degree. In some cases, the nature of that duty may exculpate the plaintiff from a claim of contributory negligence; in other cases the nature of the duty owed may reduce the plaintiff's share of the responsibility for the damage suffered; and in yet other cases the nature of the duty may not prevent a

[119] Page 14, paragraph 29.

> finding that the plaintiff failed to take reasonable care for the safety of his or her person or property. Contributory negligence focuses on the conduct of the plaintiff. The duty owed by the defendant, although relevant, is one only of the many factors that must be weighed in determining whether the plaintiff has so conducted itself that it failed to take reasonable care for the safety of its person or property."[120]

159. As in *Daniels*, the issue of fraud did not arise. It was taken as read that the want of care of the officers of the trustee company was to be attributed to the company. *Astley* is also notable for the decision that, in Australia, contributory fault is no defence to a claim in contract even where the term breached is an obligation to use skill and care running concurrently with a similar obligation in tort.

160. The authorities discussed above seem to show that, in Australia and New Zealand at least, where a company suffers damage caused by the negligence of auditors, but which is partly the fault of one or more of the directors, the auditors will be able (where the defendants have not been acting in fraud of the company) to attribute that fault to the company and obtain a reduction in their liability for damages.

Fraud

161. No such consensus has emerged in relation to fraud, but there is recent Australian authority to the effect that the position is not in principle different.

162. In *Dairy Containers Limited*, counsel for the auditors, probably anticipating reluctance on the part of the Court to attribute the employees' frauds to the company, expressly disclaimed any argument that the frauds of the employees were to be attributed to the company. For this reason the discussion of fraud in the case is strictly *obiter*. However, the argument that the auditors ran in relation to the acts of the fraudulent employees was that although their fraud was not to be attributed to the company, they had been negligent in failing to report on each other's fraud. This assertion gave rise to a consideration of the position in the case of fraud because the Court held that this supposed negligent failure to report each other was, in reality, part of the fraud. Thomas J said this:

> "… I do not think that such actions could be attributed to DCL. Their repeated fraudulent activity, including concealing that activity, was entirely outside the course or sphere of their employment.
>
> In this regard, I acknowledge that, if any one of these senior employees, particularly the general manager, had been negligent or incompetent in respect of the frauds of his co-executives, the company might properly be identified with

[120] Page 14, paragraphs 29 to 30.

> the negligent conduct of its senior executives …. The company could [counsel said] be vicariously liable for the negligent conduct of its employees committed in the course of their employment. But the conduct of the executives complained of in this case was not negligent …. it was dishonest. Certainly, an employer may be vicariously responsible for acts which are intended or wilful, or which are dishonest or even fraudulent (see *Lloyd v Grace, Smith & Co* [1912] AC 716), but the employees' action in this case in concealing, not only their own frauds, but the frauds of each other does not have about it the character of conduct which can be said to be undertaken in the course of the employment. It was dramatically and deliberately hostile to the employer's interest; it cannot be viewed as merely an unauthorised mode of performing an authorised duty; it cannot be said to be 'acts to which the ostensible performance of his master's work gives occasion or which are committed under cover of the authority the servant is held out as possessing or of the position in which he is placed as a representative of his master.'
>
> ….
>
> To my mind, therefore, the interests of the fraudsters in concealing the frauds and the interests of the company were antithetical in the extreme. It would be inappropriate to hold the company responsible pursuant to either the principle of corporate identification, the doctrine of imputed negligence, or the concept of vicarious liability. These doctrines are notoriously elastic in their definition and application, but they are not so elastic that they must be extended to behaviour which was essentially part of a programme of fraudulently bilking the company."[121]

163. For these reasons, Thomas J was not prepared to attribute the fraudulent conduct of the company's employees to it so as to constitute the company's "own fault".

164. In the recent case of *Duke Group Limited v Pilmer* [1999] SASR 64, a unanimous decision of the Supreme Court of New South Wales, the Full Court came to the opposite conclusion.[122] The plaintiff, known as Kia Ora, bid successfully for the shares in a

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[121] Page 77 line 52 to page 78, line 46.

[122] *Duke* is currently before the High Court of Australia. Special leave was given only in relation to an issue which is not relevant for present purposes. The question of contributory negligence appears unlikely to have been pursued on appeal in the light of the fact that under Australian law contributory negligence is no defence to a claim framed in contract (see paragraph 159 above). The quantum of damages awarded in contract was consequently higher than that which would have been awarded (had it been necessary to do so) in negligence after reduction for contributory negligence. We do not know

company, WUL. The directors of Kia Ora, apart from two recently appointed independent directors, held large shareholdings in WUL and were thus "associated persons" within the meaning of the relevant companies legislation and Listing Rule. This meant that the proposed take-over required the approval of Kia Ora's shareholders in general meeting and that notice of the meeting had to be accompanied by material from an independent qualified person sufficient to establish that the price offered was "fair".

165. Reporting accountants (NWP) were instructed and advised that the price was "fair and reasonable". They submitted their report shortly before the stock market crash of 1987. The directors used the report to persuade the shareholders to approve the offer, and the directors subsequently decided to proceed with it. Kia Ora went into liquidation and the liquidator sued the accountants, who joined Kia Ora's directors as third parties.[123] The judge found that WUL was at the time of valuation worth much less than the price NWP had advised was "fair and reasonable".

166. The directors, two of whom had made large sums selling their shares to Kia Ora, were held to have acted fraudulently and in breach of statutory and fiduciary duties owed to Kia Ora. The accountants had been negligent, but the directors had also misled them by failing to provide reliable information relevant to the value of WUL. The directors had contributed further to the losses by, amongst other things, using the report to promote the take-over and deciding to proceed with it knowing that the report was unreliable and knowing of the stock market crash.

167. Because in Australia the defence of contributory negligence is inapplicable to claims in contract, the eventual quantum of damages in contract was greater than that in tort after reduction for apportionment. In the result, then, the discussion of the position in tort (and thus of contributory negligence) was strictly unnecessary. But, because similar considerations were relevant in relation to the claim by Kia Ora for breach of fiduciary duty (and perhaps in anticipation of an appeal), the Full Court gave careful consideration to the question of contributory negligence.[124] On the facts, a 35 per cent reduction in the damages awarded would have been made for contributory negligence had the claim in contract covering the same loss not resulted in a higher figure.

168. On the question of the attribution of the directors' fraud to Kia Ora for the purposes of contributory negligence, the trial judge had said "it is, to my mind, an affront to common sense to attribute, or impute, their knowledge and acts to Kia Ora …. This view is clearly established by abundant authority."[125] It is to be noted that the trial judge was considering the question of the attribution of knowledge as well as acts. This is a theme that is picked up by the Full Court on appeal. The trial judge distinguished the

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whether, if the appellants succeed before the High Court of Australia, the issue of contributory negligence will become live and whether they will then seek to challenge the findings of the Court below in relation to contributory negligence (on the assumption that that would be possible as a matter of Australian procedure).

123 The directors were also subsequently joined as defendants by the liquidator.

124 Pages 181 to 199.

125 Quoted in *Duke* on appeal at 182, paragraph 572.

case of Daniels on the basis that in "that case the company was not the victim[126] as was Kia Ora."[127]

169. The Full Court referred to the decision in *Astley* in rejecting the submission that a plea of contributory negligence was not available to an accountant in the circumstances. It then considered the question of whether Kia Ora was guilty of fault, deciding that Kia Ora, by its directors, had failed to take reasonable care for its own protection.[128]

170. The Full Court then faced the issue of attribution. It posed the question, "Is the conduct that constitutes fault to be attributed to Kia Ora?"[129] It answered it in this way:

> "In our opinion, on ordinary principles, decisions by a company by its directors acting in the course of their apparent authority and decisions for which the company would be vicariously liable to a third person would be regarded as the conduct of the company for the purpose of deciding whether the company was guilty of contributory negligence: see *Daniels v Anderson* (at 569-570) Clarke JA and Sheller JA:
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> > 'the principal is identified with the wrongdoer in those cases in respect of which it would be held vicariously liable to a third party for the acts of that wrongdoer …'
>
> See also Fleming, *The Law of Torts* (9th ed, 1998), p 323. It seems to us that the case for contributory negligence based upon the conduct of directors of a plaintiff company, acting in the course of the authority committed to them, is even stronger than the case for contributory negligence based upon the conduct of one for whom the plaintiff is vicariously liable.
>
> But even the statement we have just cited from *Daniels* is of uncertain scope. In the present case, does it mean that the issue is whether Kia Ora would be vicariously liable for conduct of the directors that caused harm to another person in the course of this transaction? If that is so, what sort of event causing harm is to be envisaged? Or does it simply mean that it suffices that the directors are persons for whose torts Kia Ora would usually be liable, if those torts were committed in the course of them discharging their duties as

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126 It is assumed he meant not the victim of fraud: the company was, after all, the victim of its directors' negligence.

127 Quoted in *Duke* on appeal at 183, paragraph 573.

128 Page 188, paragraph 604.

129 Page 188, paragraph 607.

> directors? Alternatively, does the principle require consideration of the very acts under consideration? If that is so, how is the issue of vicarious liability to be tested in a case like the present, when the court has not found that the conduct of the directors inflicted tortious harm upon anyone other than the plaintiff?
>
> **We proceed hereafter on the basis that it suffices that Kia Ora would be vicariously liable for tortious harm to an innocent third party caused by the directors in the course of the events in question, while noting that there is an element of uncertainty about this.** But we also repeat that in the present case it is not necessary, in our opinion, to resort to principles of vicarious liability to make Kia Ora responsible for the conduct in question of the Board of Directors. As we have already pointed out, in our opinion their acts are, on ordinary principles, to be regarded as the acts of Kia Ora."[130] (Emphasis added)

171. Thus far, the Full Court followed *Daniels* and *Astley* and also made clear that attribution of fault to a company can take place using the company's primary rules of attribution as well as vicarious liability.

172. The Full Court then addressed the question of whether there was a principle which precluded the attribution of the directors' conduct to Kia Ora and considered passages from *Meridian* in relation to rules of attribution:

> "The present case is really the converse of *Meridian*. The primary rules of attribution, to use Lord Hoffmann's terms, attribute the relevant conduct of the directors to Kia Ora. So do the secondary rules, in the sense that the relevant conduct of the directors is conduct for which Kia Ora would be vicariously liable, if in the course of the conduct tortious harm were inflicted on an innocent third party.
>
> The issue in the present case is whether there is a special rule that prevents the attribution to Kia Ora of the conduct (involving acts and knowledge) of the directors."[131]

173. The Full Court then considered the line of English authority beginning with *Re Hampshire Land Company* [1896] 2 Ch 743 and continuing with *Gluckstein v Barnes* [1900] AC 240 (HL), *J C Houghton & Co v Nothard Lowe & Wills* [1928] AC 1 (HL), *Kwei Tek Chao v British Traders & Shippers Ltd* [1954] 2 QB 459 and *Belmont Finance*

130 Page 189, paragraphs 609 to 611.

131 Page 190, paragraph 615 to 616.

Corporation v Williams Furniture Ltd [1979] Ch 250, quoting part of the passage from the judgment of Buckley LJ set out above at paragraph 55.

174. The Court concluded:

> "It can be seen that Buckley LJ drew upon a principle of the law of agency. He applied it in the case of an action in which the tort of conspiracy was alleged. It was applied to insulate the plaintiff Belmont from knowledge of a director acting in fraud of Belmont. Belmont was the victim of the fraud. The court insulated Belmont from the knowledge of its directors even though those directors, with that knowledge, made relevant decisions at meetings of Belmont's directors, and caused it to affix its seal to relevant documents."[132]

175. The Full Court then contrasted this line of authority with *Lloyd v Grace, Smith & Co*, which it described as "another line of authority that has to be accommodated"[133]. After stating the proposition derived from that case to be that, "an employer is vicariously liable for the tort of a fraudulent employee, provided that the employee acts, subject to the issue of fraud, in the course of the employee's employment"[134], the Full Court said:

> "It is on this basis that we are able to conclude that in the present case Kia Ora would be vicariously liable for the relevant conduct of its directors and employees if the conduct was tortious and caused loss to another, even if that conduct was fraudulent and even if they were acting entirely for their own benefit. Although we are not aware of any case on point, we have no reason to think that the answer would be any different if the employee or director in question was, while defrauding the third party, also defrauding the employer."[135]

176. Before going on to consider whether this was sufficient reason to attribute contributory fault to Kia Ora, the Full Court examined one potential difficulty raised by attributing the directors' fraudulent acts to the company. Did that mean that the directors' knowledge of what they had done wrong was Kia Ora's knowledge and

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132 Page 193 paragraph 425.

133 Page 194, paragraph 628.

134 Page 194, paragraph 628.

135 Page 194, paragraph 629. The employee who defrauds a third party in the course of his employment always injures his employer as well to the extent that he exposes his employer to a liability to compensate the third party victim. Although it has been held that '[i]n judging whether the fraud was in fact harmful to the interests of the company, one should not be too ready to find such harm': *McNicholas* at 576h to j.

therefore that the company's claim should fail for that reason? In the instant case this was not a problem because there was an earlier finding that NWP was liable notwithstanding that Kia Ora's directors had acted fraudulently.[136] The Court, however, suggested that on the *Hampshire Land* principle (and also in accordance with the decision of von Doussa J in *Beach Petroleum NL v Johnson* (1993) 43 FCR 1) for the purposes of Kia Ora's claim against NWP the company was not to be treated as having the directors' knowledge.

177. The Full Court continued:

> "In our opinion the cases to which we have referred also establish that Kia Ora would, if the issue arose, be vicariously liable for the relevant conduct of its directors. That is also consistent with the decision of von Doussa J in *Beach*. What they did was done, albeit in fraud of Kia Ora, in the apparent exercise of powers conferred upon them. As we have already said, there is no case deciding that a company is not vicariously liable when the relevant director or agent is acting to harm the company, as well as to harm the person who makes a claim against the company. But we do not consider that that is a relevant distinction.
>
> We earlier noted that the relevant conduct by the directors of Kia Ora is conduct of Kia Ora under the so-called primary rules of attribution. However, as *Belmont* indicates, that does not prevent the application of a rule insulating Kia Ora from relevant knowledge.
>
> The question then becomes whether, in these circumstances, the relevant conduct of the directors is to be regarded as conduct of Kia Ora for the purposes of determining whether Kia Ora is guilty of contributory negligence. We are not aware of any authority in point. In none of the cases to which we have referred, and in none of he cases to which we were referred in argument, did this precise point arise.
>
> ….
>
> Our view is that the resolution of the issue does not depend, or at least wholly depend, upon the issue of what constitutes notice to Kia Ora.
>
> The principles relevant to the attribution of knowledge and notice to a corporation are relevant in a wide range of situations. It is established that knowledge of an agent, acting in fraud of a company, will not be imputed to the company in a variety of situations. That may have the result

[136] Pages 145 to 147.

of affecting the rights and liabilities of the company in contract and in tort.

But when considering the issue of contributory negligence, in our opinion it is relevant to consider whether the company would be vicariously responsible for the conduct or tort of the relevant agent. **In our opinion it is not a matter of attributing knowledge or conduct to the company, and then deciding that the company is guilty of fault or is to be treated as having acted with certain knowledge. *Lloyd v Grace Smith*, is, we consider, an illustration of this point. The employee committed the tort, and the employer was liable. The employer was not liable on the basis that the knowledge and acts of the employee were attributed to the employer, and that the employer had therefore committed a wrong. The principle of vicarious liability proceeds on the basis of attributing a wrong done by one person to another person.**

On the other hand, in *Belmont* the company would have been a party to the conspiracy only if Belmont had relevant knowledge. For it to be a party to the conspiracy, it was necessary for the knowledge of the relevant directors to be attributed to Belmont, and for the reasons indicated the Court declined to do so.

….

Absent any authority on point, we have come to the conclusion that the matter is appropriately resolved on the basis that Kia Ora is vicariously liable for the conduct of its directors …. [The *Hampshire Land* principle] will or may, in certain circumstances, mean that Kia Ora has certain rights, or can escape certain liabilities on the basis that knowledge or conduct is not to be attributed to it. But they do not operate to prevent the tort of another being attributed to Kia Ora by way of vicarious liability.

….

It seems to us both fair and reasonable that Kia Ora should, for the purposes of contributory negligence, be responsible for the faults of its own directors, even though they were acting in fraud of Kia Ora. … **Kia Ora would be responsible for the conduct of those directors if they were merely careless. It is not easy to see why, as between Kia Ora and NWP, the position should alter when the directors have been found to be fraudulent and in breach**

> **of other duties.** The fact is that Kia Ora entrusted its management to those directors. As between Kia Ora and NWP, we consider that it should not be said that the fault of the directors was not also a cause of the loss sustained. It is one thing to hold NWP liable despite the conduct of the directors. It is another thing altogether to exonerate Kia Ora from responsibility for the conduct of its own directors, when allocating responsibility as between Kia Ora and NWP for that loss."[137] (Emphasis added)

178. The Full Court's consideration of apportionment took account of the fact that the advice of NWP had been sought "specifically as a protection against an unwise and self-interested proposal by the directors."[138] Accordingly it allocated NWP (the reporting accountants) the major responsibility for the damage (65 per cent) despite the fact that in respect of the degree to which each of the accountants and the directors had fallen short of the degree of care required, there was no "significant differentiation"[139] to be made between them.

The position in English law

179. Would these authorities be followed by an English court? For certainly, there is very little directly relevant English authority since the 1945 Act came into force.

180. In *De Meza and Stuart v Apple* [1974] 1 Ll. Rep. 508, Brabin J had to consider the plea of contributory negligence by reporting accountants employed by a firm of solicitors to complete some consequential loss insurance certificates. The solicitors were held 30 per cent to blame.

181. In *Berg Sons & Co Ltd v. Mervyn Hampton Adams* [1993] BCLC 1045, the liquidator of what had been a one-man company sued the auditors for negligently failing, during the course of their audit, to obtain independent verification of certain bills and for failing to qualify their audit certificate on account of those bills. Hobhouse J held that the auditors had been at fault but that the company was only entitled to nominal damages. This was not because of contributory negligence but because the controlling director, who was also (indirectly) virtually the sole shareholder, knew perfectly well what the true position was, and so the company was not in any way misled by the certificate. The argument that the director's knowledge should not be attributed to the company was rejected on the ground that he had not been guilty of any criminal conduct, fraud or breach of trust or duty in relation to the relevant accounts.

182. Hobhouse J said this.

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137 Pages 196 to 198, paragraphs 640 to 651.
138 Page 199, paragraph 656.
139 Page 199, paragraph 655.

"The first plaintiffs sought to argue that the fact that Mr Golechha was at all material times fully informed and was in no way misled by the auditors' certificate was irrelevant since Mr Golechha was, they said, acting contrary to the interests of the company, Berg, and therefore his knowledge should not be attributed to the company.

They relied upon the proposition set out in *Bowstead on Agency* (15th edn, 1985), art. 102:

> 'Where an agent is party or privy to the commission of a fraud upon or misfeasance against his principal, his knowledge of such fraud or misfeasance, and of the facts and circumstances connected therewith, is not imputed to the principal.'

Thus they said that the failure of Mr Golechha to give Mr. Surrey the full facts about the Gimco bills with a view to persuading Mr. Surrey to sign an auditor's certificate which did not refer to the fact that the recoverability of the relevant debts was unverified amounted to at least a misfeasance on the part of Mr Golechha in relation to Berg.

In the present case it has not been proved that there was any fraud by Mr Golechha in relation to the 1982 audit, still less that at that time Mr Golechha was practising any fraud upon his principal, Berg. There was no entity which it can be said he misled or in relation to which it can be said that he was acting fraudulently in relation to the audit in October 1982. However one identifies the company, whether it is the head management, or the company in general meeting, it was not misled and no fraud was practised upon it. This is a simple and unsurprising consequence of the fact that every physical manifestation of the company Berg was Mr Golechha himself. Any company must in the last resort, if it is to allege that it was fraudulently misled, be able to point to some natural person who was misled by the fraud. That the plaintiffs cannot do.

The plaintiffs also sought to rely upon *Belmont Finance Corp Ltd v Williams Furniture Ltd* … . That however was a case of a very different kind. Certain directors of the plaintiff company were aware that the company had entered into an illegal transaction. [Hobhouse J. then quoted from the judgment of Buckley LJ at [1979] Ch 261-262.]

> The company could therefore sue the conspirators for the loss it had suffered as a direct result of that conspiracy. In the present case Berg suffered no prejudice as a result of any failure by [the auditors] to perform their audit with due care and skill. There was no conspiracy between [the auditors] and Mr. Golechha, let alone any conspiracy to defraud Berg."[140]

183. It can plainly be inferred that if the director had been acting in fraud of the company, Hobhouse J would not have attributed his knowledge to it.

184. In *Henderson v Merrett Syndicates Ltd (No. 2)* [1997] LRLR 265 Lloyd's names sued their managing agents and their members' agents for negligently writing certain run-off contracts and the syndicate auditors (E&W) for negligence in relation to the closing of certain years of account by way of reinsurance. E&W relied, inter alia, on the 1945 Act against the names. Cresswell J held each of the defendants liable in respect of some of the claims against them. In relation to contributory negligence he said this.

> "Having regard to the unusual and complex structure of Lloyd's and in particular to [four matters] I reject E&W's submissions. In the relevant context the negligence of Merretts' in relation to the three [reinsurances to close] is not properly attributable to the plaintiffs. If contrary to the foregoing I am wrong in the above conclusion I would in the alternative hold that in all the circumstances it is not just or equitable that the damage should be reduced having regard to the plaintiffs' share in the responsibility for the damage."[141]

It is difficult to establish from the judgment on what principle Cresswell J concluded that the agent's negligence should not be attributed to their principals. This seems to have been a case which was decided on its own particular facts.

185. In *British Racing Drivers' Club Limited v. Hextall Erskine & Co* [1996] 3 All ER 667 B was a company limited by guarantee and S was its wholly owned subsidiary. W was a member of the board of B and the chairman of the board of S. W was also the chairman and a substantial shareholder of T Limited, which carried on a retail motor business. S entered into an agreement under which it purchased T's motor retail business. The defendants, a firm of solicitors, failed to advise the board of S that, because of W's interests in the transaction, the transaction required the prior approval of the members of B pursuant to section 320 of the Companies Act 1985. The transaction was subsequently rejected by the members of B. S was only able to extricate itself at considerable loss and expense. The defendants argued, amongst other things, that the amount of any damages

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140 Pages 1064f to 1065g.

141 Page 402, column 1.

awarded against them should be substantially reduced because of the contributory negligence of the directors of B and S, which should be attributed to those companies.

186. Carnwath J dealt with this argument as follows:

> "Clearly, there is a prima facie case of negligence against the directors. As I have said, proceedings were commenced against some of the directors, and the case against them was succinctly summarised in the company's own pleadings in that action. Mr Davis asks me to find in these proceedings that the same directors, together with the three executive directors, were negligent. He accepts that he cannot rely on their individual negligence, since they are not parties to these proceedings and he has not sought to join them as contributories. However, he argues that their negligence should be attributed to the company, and that it can be relied on to reduce its clients' liability under the principles of contributory negligence.
>
> In my view, this submission fails in principle and on the facts. The theory behind the attribution of the acts for failures of individuals to a company was fully discussed by the Privy Council in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 3 All ER 918, [1995] 2 AC 500. That shows that the approach depends very much on the particular statutory context. In different cases different rules may apply to decide which individuals constitute 'the directing mind and will' of the company. The purpose of s 320, and the defendant's duty in this case, was to ensure that, in relation to a major transaction involving a director, the directing mind and will of the company would not be the board of directors unsupervised by the general meeting. For the defendants now to rely on the directors' negligence as that of the company would be wholly inconsistent with the statutory scheme.
>
> In any event, I do not think this defence is sustainable on the facts."[142]

187. The commercial judgements said to constitute fault on the part of the companies were ones the defendants knew or ought to have known could not lawfully be made by the directors on behalf of the companies, but only by the members of B in general meeting. The directors were thus not acting within the scope of their actual authority: they had no authority of any sort to make these decisions. The defendants should have known this and so advised the companies. It is therefore hardly surprising that, on a

[142] Pages 682j to 683d.

claim by the companies against the defendants, the judge refused to attribute the misjudgements of the directors to the companies.

188. Carnwath J seems to have assumed that the rule of attribution for contributory fault on the part of companies is that the fault should be that of its directing mind and will. In the civil sphere we do not believe this to be the appropriate test.[143] Although fault by someone who can be identified as the directing mind and will of the company in relation to the matter in question is likely be attributed to the company, it is plain that fault on the part of someone who is not the company's directing mind and will can, in an appropriate case, be attributed to the company. The obvious example is the careless employee driver.

189. We do not think that *De Meza*, *Henderson* or *Hextall* assist very much in the task of assessing whether, and in what circumstances, an English court would allow auditors to rely on the fault of a company's directors as contributory negligence by the company in a claim brought by it for damage caused by a negligently conducted audit.

190. The question is deceptively simple. An individual or a company owns a business. The owner appoints A and B to manage or direct that business on the owner's behalf, and appoints C to audit its annual accounts. A and B manage or direct the business in such a way as to cause the owner to suffer damage either directly themselves, or by failing to supervise and control others working in the business. C also causes the owner damage by negligently failing to discover what has happened and so enable the owner to prevent further damage, or recoup loss already suffered. The owner sues C. Should C be liable for all the damage, with a right (often worthless) to claim contribution from A and B personally? Or should the damages C has to pay be reduced to the extent that the court thinks just and equitable having regard to A and B's share in the responsibility for the damage, their fault being attributed to the owner as their principal or employer? Moreover, does it make any difference if A and B were not just negligent, but were engaged in a fraud against the owner?

191. We have already given our reasons why we think the view that the auditors should never be entitled to attribute the fault of the directors to the company is wrong. The policy reason in favour of this position is that auditors should not be entitled to rely on the very things against which they are employed to protect the company. We agree with the Commonwealth authorities that this consideration can adequately be reflected in the process of apportionment. Moreover, that it should be a complete bar to reliance upon contributory negligence seems to us inconsistent with the reasoning in *Reeves*, where Lord Hoffmann rejected the view that,

> "contributory negligence can in principle have no application when the plaintiff's carelessness is something which the defendant had a duty to guard against. It is commonly the case that people are held liable in negligence for not taking precautions against the possibility that someone may do

[143] See paragraphs 91 to 98 above.

> something careless and hurt themselves, like diving into a shallow swimming pool, but I do not think it has been suggested that in such cases damages can never be reduced on account of the plaintiff's contributory negligence."[144]

192. For these reasons, in our view Lord Alverstone CJ's direction in the *London Oil Storage* case no longer represents the law of England. An English court will, we believe, be prepared to attribute the fault of directors (who have not acted in fraud of the company) to the company for the purposes of the 1945 Act in a claim brought by the company, or its liquidator, against its auditors for negligence in the conduct of their audit.

193. The question remains, however: will it do so if the directors in question have been acting in fraud on the company? Will it follow *Duke*, which, although strictly a case about reporting accountants, seems equally applicable to auditors?

194. This is not a question that we can answer with any certainty, not least because, without facts, it is impossible to predict how the question will present itself to a court. The instinct of the courts to refuse to attribute the conduct of a company's directors and employees to it when that conduct amounted to a fraud on the company is very powerful. Thomas J followed it in *Dairy Containers***,** as did the judge at first instance in *Duke*. Moreover, it seems that Hobhouse J would have followed it in *Berg*, had the director been guilty of fraud on the company. This reluctance has at its root on an understandable unwillingness by the courts to find that a person (whether company or individual) who has himself been a victim of a fraudster is liable for the fraudulent acts which were directly contrary to his interests. [145]

195. In *Duke* the Full Court, although recognising it might also on occasion apply to conduct, treated the *Hampshire Land* principle as relating principally to knowledge, and had no difficulty with fault being attributed to a company even where knowledge of the conduct constituting that fault would not be attributed to it. As we understand it, the Full Court argued that, as the doctrine of vicarious liability allows a principal to be held responsible for a wrong he neither committed nor knew of, Kia Ora could, for the purposes of contributory fault, be held responsible for the conduct of its directors acting in fraud on itself without breaking the *Hampshire Land* principle.

196. This, however, is not entirely convincing. It is often impossible to distinguish knowledge of conduct from the conduct itself; nor does the court always do so.[146] Indeed,

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144 Page 371D to E.

145 See, on this point, Andrew Bartlett Q.C. 'Attribution of Contributory Negligence: Agents, Company Directors and Fraudsters' 114 LQR 460 at 472. See also *Dubai Aluminium v Salaam and Others* (CA) of 7.4.00, (reported Times 21.4.2000), which is another example in a different context of reluctance to hold morally innocent people liable for the frauds of others.

146 In the criminal context, see *R. v. Gomez* [1993] AC 442 (HL) where Lord Browne-Wilkinson, at 496F-G said:

in *McNicholas Construction Company Limited v HM Commissioners of Customs & Excise* [2000] STC 553, where the question was whether the acts of a company's employees engaged in a VAT fraud should be attributed to the company, Dyson J said this.

> "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."[147] (Emphasis added)

To reduce the damages recoverable by a company from auditors by treating damage caused to the company by its directors acting in fraud on it as resulting from the company's "own fault" is to attribute that fraud to the company despite it being the victim of the fraud.

197. Moreover, as Lord Jauncey said in the context of the 1945 Act in *Reeves*:

> "… the law should be interpreted and applied so far as possible to produce a result which accords with common sense."[148]

There will undoubtedly be a widely held view that common sense is against treating as a company's fault a fraud of which it is the primary, and not an incidental victim.[149]

198. If, on the other hand, auditors are to be allowed to reduce their liability to pay damages to the company because the fraud of its directors was partly responsible for the damage suffered by the company, how far should this go? Can the auditors rely only on the fact that they were dishonestly misled in the course of the audit, or can they also rely on any underlying fraud that has caused damage to the company? Does it matter whether a dishonest director's lies are aimed at deceiving current or potential creditors or shareholders (or indeed other directors) into believing the company is performing more successfully than is really the case, or are aimed at covering up his own thefts from the company? For fraudulently inflating the company's profits can cause it to suffer loss just as much as can stealing from it.

> "Where a company is accused of a crime the acts and intentions of those who are the directing minds and will of the company are to be attributed to the company. That is not the law where the charge is that those who are the directing minds and will have themselves committed a crime against the company: see *Attorney General's reference (No.2 of 1982)* [1984] QB 624 applying *Belmont Finance Corporation Ltd v. Williams Furniture Ltd* [1979] Ch. 250."

147 Age 576g to h.

148 Page 376F.

149 Examples of the latter include being left exposed to a claim by the primary victim (as in *Lloyd v. Grace, Smith & Co.* itself), or to a fine (as in *Director General of Fair Trading v. Pioneer Concrete (UK) Limited* [1995] 1 AC 456).

199. The argument that a company is responsible for (and thus to be treated as at fault in respect of) lies told to its auditors by its directors, on the principle of *Lloyd v. Grace, Smith & Co*, is a powerful one. But it does not necessarily follow that the company is to be treated as responsible for (and thus at fault in respect of) the directors' underlying fraudulent conduct (for example embezzlement from the company), though often it will be impossible to disentangle the conduct itself from its concealment. In *Daniels*, for example, (not a fraud case) it was not sought to attribute the underlying reckless and loss-making transactions carried out by K to the company. In *Duke*, on the other hand, the company was treated as responsible for the entire course of fraudulent conduct by the directors and not just for false information provided to the accountants.[150]

200. The solution to the problem of attribution must lie in Lord Hoffmann's insistence that the question must always be *for what purpose* is it being asked whether the acts of an employee or agent are attributable to the company. The answer to that here is, "In order to decide whether certain damage is the company's 'own fault' for the purposes of the apportionment of liability under the 1945 Act". For that purpose the *Hampshire Land* principle (whatever its precise ambit) should arguably not apply save as an answer to the argument that the company's claim should fail altogether because knowledge of the fraud in question is to be attributed to it.[151] As against auditors innocent of the fraud, however negligent they may have been, the company should not be entitled to disclaim responsibility for the conduct of its agents in circumstances where, if that conduct had constituted a tort against a third party, the company would have been liable for it. The company should, as against its auditors, take legal responsibility for the fraudulent conduct of its directors acting within their actual or apparent authority. And, to the extent that such conduct causes the company damage, that damage should be, for the purposes of the apportionment of liability under the 1945 Act, partly the company's "own fault".

201. In our view, although working through the implications will be very difficult, allowing auditors to rely on fraud by directors as the fault of the company produces a more satisfactory outcome than one in which damages payable by auditors to a company can be reduced if its directors were negligent but not if they were fraudulent. For then the degree of responsibility attributable to the auditors on the one hand and those who direct the company on the other can be left to the process of apportionment.[152]

202. We have no doubt, however, that this view will meet considerable resistance and may very well not prevail.

Caparo

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150 See page 181, paragraphs 567 and 568 and 187 to 188, paragraphs 597 to 605.

151 See the discussion of *Duke* at paragraph 176 above. Ordinarily, an innocent if negligent defendant sued by a fraudulent claimant would win outright: either the fraud would be treated as the effective cause of the loss or the claim would be barred on the principle *ex turpi causa non oritur actio.*

152 This is also the view of Andrew Bartlett Q.C. in the article cited above and, as we understand it, the result favoured by the Consultation Document.

203. The Consultation Document suggests that the decision in *Caparo* be reversed, wholly or partly, by statute. Such a course would enable creditors and investors to sue auditors directly for loss caused by inaccurate and negligently prepared accounts.

204. The reasoning in *Caparo* is that an auditor's certificate is produced to enable shareholders to exercise their proprietary rights as shareholders, not to inform the decisions of potential buyers or sellers of the company's shares. Like considerations, however, apply to the accounts themselves.[153] Thus at present *Caparo* protects not only the auditors, but, by parity of reasoning, also the company from being sued by such persons on the basis that the statutory accounts were misleading.

205. Creditors, of course, have claims against the company in any event. But any change in the *Caparo* rule will need to make clear whether shareholders, former shareholders, and those who were potential shareholders are entitled to sue the company for losses caused to them by investment decisions based on incorrect and negligently prepared accounts.

206. If, as in many cases, the company is insolvent, such a claim against it might not be worthwhile. However, we can readily imagine a situation where, for example, an investor sues the company and/or the auditors because of negligently audited accounts that, if competently produced, would have revealed that the company had substantially fewer assets or was substantially less profitable than appeared. The auditors were negligent, but they were also misled by the directors. The company is solvent, but the share price has fallen steeply as a consequence of a correction to the accounts and the investor has suffered a substantial loss. If the investor had known the true position, he would not have bought the shares and not suffered the loss. The investor sues the company; or he sues the auditors and they join the company for a contribution, saying that the company is liable for the negligence of the directors.

207. The end result is that, directly or indirectly, the company stands to compensate one of its members for a fall in its share price.

208. Other members, who may not have a cause of action (because, for example, they were already members and their decision to remain members was unaffected by the accounts), will not recover anything from the company for the diminution in the value of their holdings, but will instead face a further diminution in their value because the company has to make payments directly or indirectly to those who have. This may appear unattractive as a matter of policy.[154]

Contribution

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153 See *Caparo*, per Lord Jauncey at 661H to 662A.

154 Moreover, if *Caparo* is modified to allow both the company and the auditors to be sued on the basis of inaccurate and negligently prepared accounts, where the company is insolvent it needs to be clear whether the auditors can, when sued by a creditor, seek contribution from the company (assuming the company can properly be said to be liable in respect of the same damage, namely damage flowing from a negligent misstatement) or whether this would offend against the rule against double proof.

209. There remain the issues of the auditors' claim for contribution from (a) the director and (b) the company, when sued by a third party. Actions by third parties against auditors are, of course, likely to become more frequent if *Caparo* is modified by legislation, as the Consultation Document suggests[155]. The Consultation Document raises the issue of contribution at paragraphs 5.163 and 5.164, which have been quoted above.

210. Section 1(1) of the Civil Liability (Contribution) Act 1978 provides as follows:

> "Subject to the following provisions of this section, any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with him or otherwise)."

211. Claims for contribution against a director personally raise no problems of attribution.[156] The difficulties arise when it is sought to claim contribution against a company on the basis that the acts of one or more directors should be attributed to it. The specific question in contribution proceedings against the company is whether the director's breach of duty is to be attributed to the company so that the company is "is liable in respect of the same damage" as that for which the auditor is liable. It seems to us that the same problems of attribution arise as in the case of contributory negligence.[157]

212. But if *Caparo* is not modified so far as companies are concerned, the question will not arise as a company will not be liable in respect of the same damage as its auditors.

Capping auditors' liability

213. Four points occur to us on the proposal to allow auditors to cap their liability by contracting with the company and giving notice to the world of the agreed limit. First, is the cap to relate to any one claim, or to the aggregate of claims made against the auditors in respect of a single financial period, or received by the auditors during such a period? If the limit applies to aggregated claims then in order to avoid a race to judgment by claimants there would have to be some machinery for *pro rata* distribution.

214. Secondly, the issues discussed above in relation to auditors can arise in relation to all forms of professional advice to companies, for example, that of reporting (as opposed to auditing) accountants, lawyers, investment bankers and others. *Duke* and *De Meza* were reporting accountants cases. *Astley* was a solicitors' negligence case. We are aware

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155 Paragraphs 5.147 and 5.148.

156 It has already been pointed out (paragraph 127 above) that to succeed in a claim for contribution it will be necessary to show that the director has breached a duty owed to the company. This is to be contrasted with a claim of contributory negligence, where what needs to be shown is a failure by the directors to take reasonable care to safeguard the company's interests.

157 The wording of the 1978 Act makes it clearer than does that of the 1945 Act (which uses the words 'own fault') that vicarious rather than personal liability on the part of the company is all that is necessary for it to be liable to make a contribution.

of substantial English litigation (now settled) involving an accountant and an investment bank as co-defendants to a claim by a company's administrator where the contributory negligence of the company was in issue. Where more than one adviser to the company is liable to the claimant, the capping of the auditor's liability could result in the other advisers bearing a disproportionate share of liability for the loss unless they have taken measures themselves to cap their own liability.

215. Thirdly, the cap allowed by statute will presumably apply only to work done within the scope of the audit. It is, however, common for the firms that act as auditors to do work outside the scope of the audit. Indeed, that was the position in *Dairy Containers*. Arrangements will need to be made to marry any contractual limit on liability for such non-audit work with the proposed cap on liability for audit work.

216. Fourthly, the question arises whether, if there is a contractual limit on the liability of auditors, the Court will apply the limit before or after making a reduction for contributory negligence. Suppose an auditor, who has limited his liability to £2 million, negligently causes £10 million of damage in circumstances where the victim is held 50 per cent for the damage. In calculating the damages, is the 50 per cent reduction to be applied to the whole loss of £10 million or to the limit of liability of £2 million? If it applied to the former, the fact that there has been contributory negligence will make no difference to the outcome as the damages payable will be £2 million, the maximum payable by virtue of the limit. If, on the other hand, the reduction is applied to the latter, then it reduces the damages payable to £1 million.

217. A similar issue arose in *Platform Home Loans Ltd v Oyston Shipways Limited* [1999] 2 WLR 518. There a negligent valuation led to a claimant entering into a transaction that caused it £611,000 of loss, of which £500,000 (the extent of the overvaluation) was the legal responsibility of the defendants.[158] The claimant was 20 per cent to blame. The question arose whether the 20 per cent reduction should be applied to the total damage of £612,000 or to the £500,000 extent of the overvaluation.

218. The House of Lords held that the reduction under the 1945 Act should be applied to the total damage. As a result the damages awarded were increased from £400,000 (the figure awarded by the Court of Appeal) to £489,000. The House of Lords concluded that it was just and equitable to apply the reduction to the whole loss because the claimant's fault contributed to the whole loss and not just to part of it, and did not contribute to the defendants' overvaluation.

219. In the light of that decision, it seems to us that, unless it is made clear that the proposed contractual limit works otherwise, the approach of the courts will be to take the gross loss, apply the reduction for contributory negligence and only then apply the limit, rather than applying the limit and then making a proportionate reduction for contributory negligence.

[158] In accordance with *South Australia Asset Management Corp. v York Montague Ltd.* [1997] AC 191.

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