
The Fraud Exception Exposed:

A Bilta Approach to Corporate Attribution

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Introduction

Mr X is the director of a company. He is, however, a fraudster. Through his actions, he causes loss to both his company and an innocent third party. The third party proceeds to sue the company in an attempt to recover its losses. The company, in turn, sues (i) Mr X for a breach of duties owed to the company as a director, and (ii) a negligent auditor for failing to detect the fraud. On what basis, if any, should Mr X's fraud be attributed to his company in each of these claims?

In answering this question, issues surrounding corporate attribution will be addressed, paying particular attention to situations where a director has been fraudulent. The “orthodox” method of attribution in this setting has been to first presume that attribution arises and then rebut the presumption through a “fraud exception”. Generally, this will apply when it is established that the director acted in fraud against the company. The thesis advanced throughout this paper is that attribution is not susceptible to being applied in such a mechanical framework. Attempting to do so may ultimately lead to anthropomorphic reasoning which contradicts established company law principles. Furthermore, it would likely detract from the true purpose for attribution and result in unnecessarily complicated reasoning. Due to these concerns, an alternative method of attribution will be endorsed which turns on the specific facts and policies of the individual case. It is only after the context of the case has been fully considered that a principled decision regarding attribution can be reached.

This argument will be presented in four parts. First, Chapter I addresses the issue of attribution generally. It compares the two prevailing tests adopted by the courts, namely the “directing mind and will” test and the contextual rules of attribution as set out in *Meridian Global Funds Management Asia Ltd v Securities Commission*.¹ In doing so, it will be argued that the latter approach is preferable. Second, Chapter II introduces the ways in which the courts have tried to rationalise the attribution of a director's fraud. The recent case of *Jetivia SA v Bilta (UK) Ltd (in liquidation)* will also be considered.² This decision marks a significant departure from the orthodox position by placing contextual concerns at the forefront of the analysis. In this sense, the decision affirms and extends the *Meridian* approach. Despite this, there remains uncertainty regarding the function and scope of the “fraud exception”. Third, Chapter III will examine two cases to show the practical difficulties that are systemic of the presumption of attribution and the respective exceptions to it. The reasoning of the majority in *Bilta* will then be extended to these cases to demonstrate how the issues can be resolved through a contextual analysis. Finally, Chapter IV will address the existing case law regarding the attribution of fraud. In relation to the three different claims identified in the hypothetical above, it will be

¹ *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500 (PC) [*Meridian*].

² *Jetivia SA v Bilta (UK) Ltd (in liquidation)* [2015] UKSC 23, [2015] 2 WLR 1168 [*Bilta*].

demonstrated that fraud is incapable of providing a principled base on which the decision to attribute rests. Rather, each context is distinct in and of itself and must be examined in relation to its own facts and underlying policies. The approach in *Bilta* achieves this.

Chapter I: Corporate Attribution

Upon incorporation, a company gains its own legal personality which is distinct from that of its shareholders.³ Although this means that the company is capable of exercising rights and assuming obligations, it does not become a natural person. It is a legal fiction and is entirely abstract and artificial.⁴

As the company does not have a body or a mind, it is necessary to attribute it with the acts or state of mind of an individual. This begs the question of how and when it is appropriate to do so. Complicated by two different lines of authority, the courts have struggled to provide a principled answer to this question. This chapter aims to set out and analyse these approaches.

A. The Meridian Approach

Meridian is a Privy Council decision appealed from New Zealand. It is the leading case on corporate attribution through its widespread application in both civil and criminal cases.⁵ Lord Hoffmann's judgment in that case was a deliberate attempt to bring clarity to the law by defining the scope and parameters of attribution. In doing so, he identified three rules to determine which acts and states of mind can count as that of the company.

First, the "primary rules of attribution" are provided by statute, the company's constitution, or common law.⁶ The primary rules are generally concerned with the board or shareholders acting collectively to make a decision of the company.⁷ Any such decision will often regard the fundamental organisation and core functions of the company.⁸ An example is where the decision by the shareholders to appoint members of the board is to be considered a decision of the company.⁹ In practice, there are few primary rules.¹⁰

Second, Lord Hoffmann recognised the "general rules of attribution", which apply equally to individuals as to companies.¹¹ The general rules anticipate the company appointing agents and

³ Companies Act 1993, s 15; See also *Salomon v Salomon & Co* [1897] AC 22 (HL).

⁴ Peter Watts, Neil Campbell and Christopher Hare *Company Law in New Zealand* (3rd ed, LexisNexis, Wellington, 2016) at 25.

⁵ John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2013) at 175-176.

⁶ *Meridian*, above n 1, at 506. An example of a common law primary rule is the unanimous consent principle: see generally *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Ltd* [1983] Ch 258 (Ch).

⁷ Susan Watson "Conceptual Confusion: Organs, Agents and Identity in the English Courts" (2011) 23 SAclJ 762 at 787.

⁸ Watson, above n 7, at 784.

⁹ *Meridian*, above n 1, at 506.

¹⁰ Watts, Campbell and Hare, above n 4, at 28.

¹¹ *Meridian*, above n 1, at 506.

servants to carry out the functions of the company. This allows the company to assume liability in one of two ways. First, vicarious liability may hold a company strictly liable for the wrongdoing of someone else but does not involve any attribution of wrongdoing to the company.¹² Second, under the principles of agency the wrongdoing of the individual can be attributed to the company to make the company primarily liable.

Together, Lord Hoffmann believed that the primary and general rules would usually be sufficient to “determine [the company’s] rights and obligations”.¹³ To deal with the cases where those rules alone do not provide the answer, Lord Hoffmann fashioned the “special rules of attribution”.¹⁴ These apply when a substantive rule of law, either expressly or by implication, excludes attribution on the basis of the general rules.¹⁵ The special rules will be required in all situations where a statutory or legal rule requires the knowledge or act of a company to be “primary”, but it is not provided for by the primary or general rules.¹⁶ An example is where, like in *Meridian*, a statute requires “some act or state of mind on the part of that person ‘himself’, as opposed to his servants or agents.”¹⁷ Lord Hoffmann reasoned that the application of the special rules is a matter of interpretation:¹⁸

... given that [the rule of law] 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?

Lord Hoffmann’s judgment was accepted as creating a contextualist approach whereby an individual’s act or state of mind will be attributed to the company only if there is a reason to do so.¹⁹ Seen as providing “flexibility into a difficult area of the law”, this approach received academic and judicial support.²⁰ While Lord Hoffmann’s approach was heard and applied in the majority of cases following *Meridian*, a competing test continued to be used. This brought confusion to the rules of attribution.

B. The “Directing Mind and Will” and Anthropomorphism

¹² Farrar and Watson, above n 5, at 190.

¹³ *Meridian*, above n 1, at 507.

¹⁴ At 507.

¹⁵ At 507.

¹⁶ Watson, above n 7, at 788.

¹⁷ *Meridian*, above n 1, at 507.

¹⁸ At 507.

¹⁹ See generally Eilis Ferran “Corporate Attribution and the Directing Mind and Will” (2011) LQR 239; Jennifer Payne “Corporate Attribution and the Lessons of Meridian” in Paul Davies and Justine Pila (eds) *The Jurisprudence of Lord Hoffmann: A Festschrift for Leonard H Hoffmann* (Hart Publishing, Oxford, 2015); and P Watts and F Reynolds (eds) *Bowstead & Reynolds on Agency* (20th Ed, Sweet & Maxwell, London, 2014) at 16.

²⁰ LS Sealy “The Corporate Ego and Agency Untwined” [1995] CLJ 507 at 509.

The directing mind and will test predates *Meridian* by eight decades and was originally formulated in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd*.²¹ In determining whether knowledge was to be attributed to the company, Viscount Haldane held that it was necessary to identify the “directing mind and will” who was the “life and soul” or “embodiment” of the company.²² Where such a person could be identified, their act or mind was presumed to be the that of the company itself. At first glance, this test may appear attractive by making the task of attribution simple in that any acts or knowledge of the identified individual can be considered the company’s. For this reason, this test quickly gained traction and grew to doctrinal status.²³

Nevertheless, under the surface, the directing mind and will test is problematic. First, an automatic, non-specific method of attribution removes any principled basis for attribution. While the acts of the directing mind and will *could* be attributed, blind adherence to the rule prevents the courts from asking *why*.²⁴ To make reference to the fact that the individual is the “directing mind and will” is clearly circular.²⁵ Although the law later developed to allow different people to be considered the “directing mind and will” for different purposes,²⁶ the test would still cause attribution to be automatic in small, closely held companies where management cannot be diffused.²⁷

Second, and more importantly, case law following *Lennard's Carrying Co Ltd* began to blur the line between the directing mind and will and the company itself when applying the test. The courts developed the idea that the company has a mind of its own and is able to engage in behaviour like a natural person. A famous example of this anthropomorphic reasoning is provided by *HL Boton (Engineering) Co Ltd v T J Graham & Sons Ltd* where the company was considered to display human characteristics:²⁸

It has a brain and a nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre.

With respect, this reasoning ignores basic company law principles. Without human assistance, companies are legal abstractions incapable of thinking or acting. Indeed, the very concept of a

²¹ *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 (HL).

²² At 713.

²³ *El-Ajou v Dollar Land Holdings Plc (No. 1)* [1994] 2 All ER 685 (CA) at 695.

²⁴ Ernest Lim “A Critique of Corporate Attribution: 'Directing Mind and Will' and Corporate Objectives” [2013] JBL 333 at 334.

²⁵ Ernest Lim, above n 24, at 334.

²⁶ See generally *El-Ajou v Dollar Land Holdings Plc*, above n 23.

²⁷ Lim, above n 24, at 333.

²⁸ *HL Boton (Engineering) Co Ltd v T J Graham & Sons Ltd* [1957] 1 QB 159 (CA) at 172.

separate legal personality is merely a convenient shorthand to the underlying rules of attribution.²⁹ This exact point was emphasised by Lord Hoffmann in *Meridian* where:³⁰

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*,³¹ 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.

Once this is understood, it becomes apparent that a company itself never acts. Although the acts of individuals can be attributed to it in certain circumstances, this does not mean that the company has *actually* performed those acts itself. This is the critical misunderstanding stemming from the metaphysical nature advanced by the directing mind and will test. At all times, the company will only ever be *deemed* to have acted in that particular way, for the purpose that the act was attributed.³² As will be demonstrated in Chapter III, this is a fine but very important distinction.

Despite the shortcoming of the directing mind and will test, Lord Hoffmann in *Meridian* recognised that it "will often be the most appropriate description of the person designated by the relevant attribution rule".³³ However, as attribution was determined to be a question of construction and not anthropomorphism, the directing mind and will could not be considered a substantive test in and of itself.³⁴ At most, the directing mind and will inquiry could be one instance of the special rules of attribution.³⁵ This remark should have spelled the end for the directing mind and will test, or at least a much refined application.³⁶ Unfortunately, this was not the case. Some courts continued to apply the test and, as a result, arrived at strained

²⁹ J Armour and M Whincop "The Proprietary Foundations of Corporate Law" (2007) 27 OJLS 429 at 461.

³⁰ At 506-507.

³¹ "Ding an sich" is a German phrase used by Immanuel Kant. It reflects the noumenon theory that an object is a thing-in-itself, as opposed to the phenomenon theory where the object is viewed and defined through human perceptions and constructs. To state that a company is "no *ding an sich*", Lord Hoffmann is referring to the fact that a company does not exist except for the meaning provided to it by humans.

³² Peter Watts "Company Controllers, their Companies, and their Companies Creditors – Dealing with Pleas of Ex Turpi Causa" [2014] JBL 161 at 166.

³³ At 511.

³⁴ *Meridian*, above n 1, at 511-512.

³⁵ Watts, Campbell and Hare, above n 4, at 31.

³⁶ See generally RJ Wickins "Confusion Worse Confounded: The End of the Directing Mind and Will Theory" [1997] JBL 524 at 550.

outcomes and unnecessarily complicated reasoning. This will be explored further in Chapter III.

Chapter II: The Fraud Exception

A. Introduction

Beginning with *Stone & Rolls Ltd v Moore Stephens*,³⁷ there has been a recent trend of using attribution as a defence by a third party or a fraudulent director against a claim brought by a company. These cases contemplate the situation where a director's fraud causes loss to either a third party or to the company itself. The argument goes that the company should be attributed with the knowledge of the rogue director, resulting in the company itself being considered fraudulent. In such circumstances, the defendant can then rely on the illegality defence³⁸ which holds that "[n]o court will lend its aid to a man who founds his cause of action on an immoral or an illegal act."³⁹ Attribution in this context is important as the illegality defence requires that the company be primarily, as opposed to vicariously, liable.⁴⁰ As the company would only be in a position to bring a claim by virtue of its fraud, it follows that its claim against the director or third party would be barred.

This raises the complex question of when, if ever, a company can deny that the fraud of a seemingly relevant agent is the fraud of the company. At this point it is necessary to identify three general circumstances where a director's fraud towards the company may be important in assessing civil liability. These are: (i) where a third party brings a claim against the company for loss suffered by that third party, (ii) where the company brings a claim against the rogue director for a breach of directors' duty and (iii) where the company brings a claim against a third party in relation to the loss suffered by the company. In dealing with such situations, the courts have struggled to arrive at a principled basis for deciding whether the director's misconduct can be considered that of the company.

This chapter will first briefly set out the historical foundations of the so-called "fraud exception" to attribution through an analysis of *Re Hampshire Land Co*.⁴¹ The recent decision of *Jetivia SA v Bilta (UK) Ltd (in liquidation)* will then be examined. Although it will be

³⁷ *Stone & Rolls Ltd v Moore Stephens* [2009] UKHL 39, [2009] 1 AC 1391 [*Stone & Rolls*]. This case was not the first to use attribution in this sense, but it was the beginning of the recent trend.

³⁸ The illegality defence is also known as the *ex turpi causa* defence. For simplicity, this paper refers to the defence as the former.

³⁹ *Holman v Johnson* (1775) 1 Cowp 341 (KB) at 343.

⁴⁰ It is noted that this point was merely conceded in *Stone & Rolls*, above n 37 at [8]. However, the proposition was supported by Lord Sumption in *Jetivia SA v Bilta (UK) Ltd (in liquidation)* [2015] UKSC 23, [2015] 2 WLR 1168 [*Bilta*] at [80] although it was not endorsed by Lord Mance at [48] or Lord Neuberger at [29]. The distinction was not discussed in the recent illegality case *Patel v Mirza* [2016] UKSC 42, [2016] 3 WLR 399. Further, limiting the defence to primary liability has been criticised in Peter Watts "*Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm): Audit Contracts and Turpitude*" (2010) 126 LQR 14 ["*Audit Contracts and Turpitude*"] at 17. As there is no clear authority on point, and the issue is not pivotal to this paper, it will be assumed that Lord Sumption in *Bilta* was correct in stating that primary liability is a necessary element.

⁴¹ *Re Hampshire Land Co* [1896] 2 Ch 743 (Ch).

submitted that the reasoning of the Supreme Court of the United Kingdom ultimately provided much needed clarity, certain shortfalls of the case will be considered.

B. Re Hampshire Land Co

The fraud exception is often termed the *Hampshire Land* principle after the case which is commonly regarded as establishing it.⁴² This case remains a good example of the early application of the exception and is a highly cited authority on point. In the case, a resolution was passed by the shareholders of Hampshire Land to borrow money from a related building society. However, there were defects in the notice requirements for the shareholders meeting, meaning the resolution was void. The funds were then borrowed from the building society where Mr Wills was secretary. Mr Wills was also a secretary at Hampshire Land and knew about the irregularities in the notice. The question for the court was whether Mr Wills' knowledge could be attributed to the building society.

In considering the basis to attribute knowledge where an officer held a similar position at related companies, Vaughan Williams J held that generally:⁴³

the knowledge which has been acquired by the officer of one company will not be imputed to the other company, unless the common officer had some duty imposed upon him to communicate that knowledge to the other company, and had some duty imposed on him by the company which is alleged to be affected by the notice to receive the notice.

...if Wills had been guilty of a fraud, the personal knowledge of Wills of the fraud that he had committed upon the company would not have been knowledge of the society of the facts constituting that fraud; because common sense at once leads one to the conclusion that it would be impossible to infer that the duty, either of giving or receiving notice, will be fulfilled where the common agent is himself guilty of fraud.

On the facts, Vaughan Williams J held that it did not matter whether Mr Wills' knowledge amounted to actual fraud or a mere breach of duty. On either account, his knowledge could not be that of the society.⁴⁴ Although not expressly stated in the case, the rationale behind this decision was that it would be “contrary to common sense and justice to attribute to a principal knowledge of something that his agent would be anxious to conceal from him”.⁴⁵

⁴² There is some doubt as to whether this case was actually the origin of the exception. See Peter Watts “Imputed Knowledge in Agency Law – Excising the Fraud Exception” (2001) 117 LQR 300.

⁴³ At 748-49.

⁴⁴ At 749.

⁴⁵ *Stone & Rolls*, above n 37, at [43] per Lord Phillips.

Through the application of *Hampshire Land* in subsequent cases, this slender authority became the foundation for the principle that an officer's fraud will not be attributed to the company when the fraud is being practiced on the company itself.⁴⁶ The exception typically operates in a strict sense to dis-attribute the director's fraud once the fraud is established. Arguably, this is a significant expansion of *Hampshire Land* which could conceivably be contained to an authority dealing only with attribution in situations where an officer holds a similar position at a related company. Nevertheless, this paper does not aim to provide a detailed history of the fraud exception and does not attempt to offer a rationalised account of its development. Rather, it will proceed on the basis that "the appeal to history, however fascinating it may be, is water under the bridge".⁴⁷

While the fraud exception has been recognised in New Zealand, the law is relatively underdeveloped in relation to the United Kingdom. In the few cases that the fraud exception has been considered, it has been done in direct reference to United Kingdom authority and is often at a low level or in obiter dictum.⁴⁸ Consequently, domestic case law will not be the focus of this paper. Rather, the developments in the United Kingdom will be analysed for the benefit of future jurisprudence in New Zealand.

C. *Jetivia SA v Bilta (UK) Ltd (in liquidation)*

The recent decision of *Bilta* is undoubtedly the leading authority on the fraud exception. Although it does not give rise to a precise formulation of when a company can deny that a director's fraud is its own, aspects of the case take a significant step in the right direction. Accordingly, this part will set out in detail the respective judgments in *Bilta*, expanding and critiquing where necessary.

Bilta (UK) Ltd ("Bilta") was in effect a "one-person" company.⁴⁹ It had two directors, Nazir and Chopra ("the directors"), with the latter owning all of the issued shares. The sole function of Bilta was to trade in European Emissions Trading Scheme Allowances (EUAs), commonly known as carbon credits. Bilta purchased a large number of EUAs from overseas suppliers which were not subject to VAT. The EUAs were then on sold to domestic purchasers at a

⁴⁶ See generally, *Belmont Finance Corporation Ltd v Williams Furniture Ltd* [1979] Ch 250 (CA); *Attorney-General's Reference (No 2 of 1982)* [1984] 1 QB 624 (CA); *McNicholas Construction Co Ltd v Customs and Excise Commissioners* [2000] STC 553 (QB); *Stone & Rolls*, above n 37; and *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* [2014] HKCFA 22, [2014] 3 HKC 323 [*Moulin Global Eyecare*].

⁴⁷ Robert Merkin "Fraud and Insurance Agents: The Law after Moore Stephens" in Thomas D Rhidian (ed) *The Modern Law of Marine Insurance* (London, 2010) 59 at 71.

⁴⁸ See generally *Ex parte Batham* (1888) 6 NZLR 342 (CA); *Cole v Wellington Dairy Farmers Co-Operative Association* [1917] NZLR 372 (HC); *Equiticorp Industries Group Ltd (in statutory management) v Attorney-General (No 47)* [1996] 3 NZLR 586 (HC); *Nathan v Dollars & Sense Ltd* [2006] 1 NZLR 490 (HC); and *Icon Central Ltd v Collingwood* HC Auckland CIV-2008-404-7424, 25 November 2009.

⁴⁹ The term "one-person" company is being used loosely here to refer to a company that has no innocent directors or shareholders. This definition will be considered further in Chapter IV.

before-VAT price lower than Bilta had purchased them for. Bilta was therefore insolvent at all times as it did not receive enough revenue to meet its liabilities to HM Revenue and Customs (HMRC). Any money that Bilta did receive from the sale of the EUAs was either paid to Bilta's supplier or to offshore bank accounts. Throughout trading, Bilta paid no VAT to HMRC and incurred a liability in excess of £38 million. As expected, liquidators were appointed for Bilta on the application of HMRC.

The liquidators brought proceedings against both the directors as well as the co-conspirators, which included Jetivia who was an offshore supplier to Bilta. The claim alleged that the defendants had breached their fiduciary duties to Bilta by engaging in the fraudulent and damaging conduct toward the company. In response to this claim, the defendant's argued that the directors' fraud was attributable to Bilta, and that the illegality defence therefore prevented the liquidator's claim. The primary issue for the Supreme Court was whether it was appropriate to attribute the fraud to Bilta.

The Court was unanimous in holding that the directors' fraud was not attributable to the company. The common rationale for this decision was that doing so would go against common sense and would arrive at an unjust outcome where a director could use their fraud to insulate themselves from liability for that very fraud.⁵⁰ Although the court was unanimous in the outcome, it was divided in reasoning. In particular, there was disagreement as to the nature and scope of the fraud exception. Lords Sumption extended the orthodox approach through applying the fraud exception to rebut the presumption of attribution which arose on the facts. Lord Neuberger (with whom Lords Clarke and Carnwath agreed), Lord Mance and Lords Toulson and Hodge (in obiter) all took a different approach to Lord Sumption and cast doubt on the very existence of the fraud exception.

1 Lord Sumption

In discussing attribution generally, Lord Sumption began by making reference to *Meridian*. The rules of attribution were considered to be a mechanism for identifying the directing mind and will of the company.⁵¹ This reasoning applied even to the function of the special rules.⁵² With respect, this is an incorrect interpretation of *Meridian*. As explained in Chapter I, Lord Hoffmann specified that the "directing mind and will" was only one manifestation of the special rules of attribution. Indeed, the focus of *Meridian* was to shift the jurisprudence away from the directing mind and will and towards a contextualist approach.

⁵⁰ *Bilta*, above n 2, at [30] per Lord Neuberger, [42] per Lord Mance, [89] per Lord Sumption and [206] per Lords Toulson and Hodge.

⁵¹ At [67].

⁵² At [67].

By setting this interpretation as the basis of the judgment, Lord Sumption unduly relied on the directing mind and will principle in his analysis.⁵³ As a result, he fell into the common mistake of applying a presumption of attribution. This is evident when Lord Sumption stated that “attribution may apply regardless of the nature of the claim or the parties involved”.⁵⁴ This, again, goes directly against *Meridian* where Lord Hoffmann was careful to state that attribution was a question of construction in each case.⁵⁵ It is not true that “whenever a servant of a company has authority to do an act on its behalf, knowledge of that act will for all purposes be attributed to the company”.⁵⁶ In terms of agency law, which Lord Sumption assumed was the basis of attribution,⁵⁷ the same point has been emphasised in *Bowstead & Reynolds on Agency* where it was stated that “[b]efore imputation occurs, there needs to be some purpose for deeming the principal to know what the agent knows. There is none in this type of case.”⁵⁸

Building upon his presumption of attribution, Lord Sumption referred to the fraud exception.⁵⁹ This was considered to be a rule of public policy⁶⁰ and was applied as “an exception from the normal rules of attribution... when it is sought to attribute to a principal knowledge of his agent’s fraud”.⁶¹ However, this description itself is flawed due to the position that Lord Sumption arrived at through the erroneous interpretation of *Meridian*. It is impossible to say that the fraud exception acts to rebut the “normal rules of attribution” when the rules of attribution do not impose any presumption. Rather, a more accurate description of the exception advanced by Lord Sumption is simply an “exception to the directing mind and will test”.

In determining the scope of the exception Lord Sumption recognised that attribution of the directors’ fraud would only be appropriate in certain circumstances. Accordingly, the exception would have limited application, if any, in the situation where (i) a third party sues the company for a wrong,⁶² or (ii) the company sues a third party who was not involved in the directors breach of duty for an indemnity against the consequences.⁶³ The reasoning behind the limited application in certain circumstances is not currently relevant and will be fully set out in Chapter IV. Lord Sumption considered the paradigm example of where the exception would apply was

⁵³ It should be noted that Lord Sumption may have felt compelled to deal with the case in such a manner due to Bilta’s counsel referring to the directors as the directing mind and will in their amended statement of claim.

⁵⁴ At [86].

⁵⁵ At 511.

⁵⁶ *Meridian*, above n 1, at 511.

⁵⁷ At [86].

⁵⁸ P Watts and F Reynolds (eds) *Bowstead & Reynolds on Agency*, above n 19, at 551.

⁵⁹ Lord Sumption at [71] termed the exception the “breach of duty exception” as it was not considered to be limited to fraud. For the purposes of this paper, the exception will continue to be referred to as the “fraud exception”.

⁶⁰ *Bilta*, above n 2, at [86].

⁶¹ At [71].

⁶² At [88].

⁶³ At [91].

when, like in *Bilta*, a company attempts to sue its fraudulent director or co-conspirator.⁶⁴ If attribution occurred, Lord Sumption believed a remarkable paradox would be created where a mere breach of duty would be enough to make that breach unenforceable by the company against the director.⁶⁵ On the facts of *Bilta*, this meant that the fraud exception prevented the fraud from being attributed to the company.

While it is conceded that this approach ultimately arrives at the correct result, it is submitted that the reasoning is not optimal. By stating that the fraud exception is applicable in certain situations only, it is implicitly but necessarily contextual. On Lord Sumption's account, the application of the exception can only be ascertained through examining the background policies of the case and the purpose for attribution with reference to the desired outcome. Although this is a significant advancement on the previous strict application of the fraud exception, it is difficult to see why an exception is necessary when attribution in the first instance should turn on those same contextual concerns. This point was made by *Bowstead & Reynolds on Agency*:⁶⁶

"The simple point is that, were the principal deemed to possess the agent's knowledge of his own breaches of duty, and thereby to have condoned them, the principal could never successfully vindicate his rights. ... [T]here is no need for an exception as such. The putative defence that the exception is used to rebut is premised on the fallacy that the principal is prima facie deemed to know at all times and for all purposes that which his agents know. As observed already, imputation never operated in such a way.

With respect, it follows that Lord Sumption's contextual formulation of the exception should not be considered "another way of putting the same point" as Lord Hofmann's method of attribution⁶⁷ - although, given Lord Sumption's misinterpretation of that case, it is perhaps not surprising that they were considered synonymous. On the facts of *Bilta*, Lord Sumption would first presume attribution as the directors were unambiguously the directing mind and will and would then dis-attribute the fraud on the policy grounds that it would make directors' duties unenforceable. However, under *Meridian*, the Court would begin by establishing the context for attribution and, upon finding that there was no purpose to serve through attribution, would elect not to attribute the fraud at all. In effect, therefore, Lord Sumption put the cart before the horse. Although this distinction is purely academic in *Bilta* as the two approaches arrived at the same outcome, Chapter III will demonstrate that this will not always be the case.

⁶⁴ At [89].

⁶⁵ At [89].

⁶⁶ Watts and Reynolds (eds) *Bowstead & Reynolds on Agency*, above n 19, at 550-551.

⁶⁷ *Bilta*, above n 2, at [92].

2 *The Majority*

(a) Lord Neuberger and Lord Mance

Lord Neuberger (with whom Lords Clarke and Carnwath agreed) advanced a different approach to attribution, which was more closely aligned with *Meridian* than Lord Sumption's reasoning. This approach was expressly endorsed by Lord Mance in a concurring judgment.⁶⁸ It gains further support through the obiter dictum of Lords Toulson and Hodge. Lord Neuberger's approach can therefore be considered that of the "majority".

In determining that Lord Sumption and Lords Toulson and Hodge arrived at the same result, Lord Neuberger was hesitant to enter any substantive discussion regarding the correct way for determining when a director's fraud can be considered that of the company.⁶⁹ Despite this, he did express in general terms that the fraud exception "is not so much an exception to a general rule as part of the general rule".⁷⁰ This was echoed by Lord Mance where it was held that it is not appropriate to "analyse the present case as one of prima facie attribution, which is then negated under a [fraud] exception".⁷¹

From this position, their Lordships argued that attribution is an open ended inquiry where the nature and factual context of the claim must be assessed in determining whether attribution will occur.⁷² Lord Mance further noted that this allowed a company to "rely on attribution for one purpose, but disclaim attribution for another".⁷³ In the situation of a company claiming against its fraudulent director, the company must not be attributed with the fraud, otherwise it "would ignore the separate legal identity of the company, empty the concept of duty of content and enable the company's affairs to be conducted in fraud of creditors".⁷⁴ Accordingly, the directors' fraud was not attributed to Bilta and the illegality defence could not apply.

(b) Lords Toulson and Hodge

Lords Toulson and Hodge deviated from the other Law Lords by viewing the case as one primarily regarding the illegality defence and not of attribution. Through an appeal to public policy, they recognised that the illegality defence in this context would place obstacles in the way of the enforcement of directors' duties.⁷⁵ On this basis, it was not necessary to consider

⁶⁸ At [33].

⁶⁹ At [9]. Lord Mance displayed similar reservations at [45].

⁷⁰ At [9].

⁷¹ At [37].

⁷² At [9] per Lord Neuberger and [44] per Lord Mance.

⁷³ At [43].

⁷⁴ At [42].

⁷⁵ At [129].

the grounds for attribution as the illegality defence would not apply to bar Bilta from suing its directors.⁷⁶ This reasoning is particularly attractive in light of the recent case *Patel v Mirza*, where the illegality defence was provided with more flexibility than the previous strict application by assessing “how illegal the illegality was or how much it matters”.⁷⁷ In that case, the claimant sought to recover in restitution money paid to the defendant for the commission of an illegal act which was never completed. However, the case did not involve any issue of attribution or company law. Moreover, the type of illegal activity in *Patel* was very different to the fraud or breach of duty considered in this paper. Due to these distinguishable features, it is unclear what effect *Patel* will have in this realm in the future.⁷⁸

In any case, there will still be situations where the illegality defence will not be contrary to public policy. It follows that attribution of a director’s fraud must still be relevant if a company is to be caught by the illegality defence in such circumstances. Accordingly, despite the fascinating development in this area, this paper’s focus will remain on the attribution of a director’s fraud. Where the illegality defence is mentioned, it will be assumed that the defence will apply to prevent the relevant claim.

Despite the reliance on the illegality defence, in the “hope of providing some clarification”, Lords Toulson and Hodge addressed the issue of attribution in obiter dictum.⁷⁹ Like Lord Neuberger and Lord Mance, and in contrast to Lord Sumption, it was stated that:⁸⁰

It has become common to speak of "the *Hampshire Land* principle" or the "fraud exception" as the exception to an otherwise general rule that attribution occurs. It is our view that "the fraud exception" is not confined to fraud but is simply an instance of a wider principle that whether an act or a state of mind is to be attributed to a company depends upon the context in which the question arises.

In discussing the contextual nature of attribution, Lords Toulson and Hodge endorsed *Bowstead & Reynolds on Agency* where it was stated that the question of whether “knowledge is imputed in law turns on the question to be addressed”.⁸¹ Significantly, this was held to apply “in relation to each category of rules of attribution”.⁸² The scope of the context was stated, in reference to *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue*, as

⁷⁶ It should be noted that this is a broad application of the illegality defence and did not have the support of the rest of the Supreme Court.

⁷⁷ *Patel v Mirza*, above n 40 At [262] per Lord Sumption.

⁷⁸ The author notes that it is at least arguable that, if Bilta were to be reheard in light of *Patel*, no issue of attribution would arise.

⁷⁹ At [166].

⁸⁰ At [181].

⁸¹ P Watts and F Reynolds (eds) *Bowstead & Reynolds on Agency* (19th Ed, Sweet & Maxwell, London, 2010) at [8-213].

⁸² *Bilta*, above n 2, at [191].

“includ[ing] not only the factual and statutory background, but also the nature of the proceedings in which the question [of attribution] arises”.⁸³

Like Lord Mance, Lords Toulson and Hodge then proceeded to address the three different circumstances where a director’s fraud towards the company may be relevant in assessing civil liability.⁸⁴ It naturally followed from taking a contextual position where attribution depends on the nature of the claim, that attribution can occur in one circumstance but not the other. Accordingly, while a director’s fraud may be attributed to the company where a third party sues the company to recover a loss associated with that fraudulent act, it does not follow that the fraud is attributed where the company seeks to bring a claim against the director. In each of these circumstances, the context and purpose for attribution is different.

(c) Discussion

Although not expressly articulated in any judgment, the majority’s contextual reasoning assumes that at all times the company is a neutral entity and has never actually committed a wrong. This is entirely consistent with the analysis from Chapter I and must be considered the “only workable view”.⁸⁵ Where primary liability is imposed on the company through the attribution of fraud, the company can be *deemed* a wrongdoer for that purpose, and that purpose only.⁸⁶ However, as the company is not an *actual* wrongdoer, it is free to pursue claims against, for example, its fraudulent directors. In this regard, the company is conceived in the same light as an absentee unincorporated business owner who leaves the running of the business to his managers while he spends his days on the grouse moors.⁸⁷ This is an important point where a company is intended to be subject to the same rules as they would apply to natural persons.⁸⁸

This is a conclusion which Lord Sumption’s judgment would struggle with. By holding that attribution applies “regardless of the nature of the claim or the parties involved”, Lord Sumption goes dangerously close to making the acts of the director synonymous with the acts of the company.⁸⁹ On this basis, it is easy to see how a court could resort to the same anthropomorphic reasoning that frequently accompanies the directing mind and will test. Indeed, Chapter III will show that some courts have fallen into that exact trap where the company is treated as being a wrongdoer itself for all purposes, irrespective of context. With

⁸³ *Moulin*, above n 46, at [113].

⁸⁴ At [204]-[207]. For more detail on the three situations, refer to the Chapter II introduction above.

⁸⁵ *Watts*, above n 32, at 166.

⁸⁶ *Watts*, above n 32, at 166.

⁸⁷ *PCW Syndicates v PCW Reinsurers* [1996] 1 WLR 1136 (CA) at 1142.

⁸⁸ Peter Watts “Illegality and Agency Law: Authorising Illegal Action” [2011] JBL 213 [“Illegality and Agency Law”] at 218; see also *Bilta*, above n 2, at [47] per Lord Mance.

⁸⁹ At [86].

respect, this is an unsatisfactory position to hold where a company is incapable of *actually* acting or thinking.

The open-ended nature of the majority's approach has been criticised for not providing as much certainty as that advanced by Lord Sumption.⁹⁰ Respectfully, this cannot be correct. It is submitted that any certainty provided by Lord Sumption's approach above that of the majority is illusory and merely a façade through the use of terms such as "presumptions" and "exceptions". When the court applies the fraud exception, it only does so through reference to the desired outcome and, if necessary, will fashion exceptions to the fraud exception to suit the context. This results in a rule of inconsistent application and offers no more certainty than the majority's approach.

D. Conclusion

Two significant points emerge from *Bilta* in relation to the attribution of a director's fraud. First, there is continued disagreement over the nature and existence of the fraud exception. Lord Sumption advocated for an exception-based approach. This reasoning, however, endorses the same fallacious presumption as the directing mind and will test, which can cause courts to slide into anthropomorphic reasoning.

Lord Neuberger, Lord Mance and Lords Toulson and Hodge, on the other hand, avoid this confusion by making it extremely clear that any presumption of attribution and reliance on an "exception" is misplaced. Rather, in their opinion, attribution will only arise after the context has been analysed and an appropriate reason for attribution ascertained. It is submitted that this flexible reasoning provides the judiciary with the appropriate tools to arrive at a principled outcome. The importance of this conclusion will be seen in Chapter III where the majority's approach allows the court to properly consider the context of the case, without the risk of treating a company wrongdoer for all purposes.

The second, and more significant, point to be extracted from *Bilta* is the fact that the Court unanimously departed from a method of attribution that did not recognise the underlying context of the case. As will be illustrated in both Chapter III and IV, this conclusion must be correct. Any other alternative could lead the court to absurd outcomes and an unprincipled method of attribution.

While this contextual nature of attribution echoes and pays respect to that in *Meridian*, it is arguable that *Bilta* actually extends the reasoning from that case. In *Meridian*, Lord Hoffmann employed the special rules of attribution with respect to a single substantive rule, namely s 20

⁹⁰ Ernest Lim "Attribution and the Illegality Defence" (2016) 79 MLR 476 at 479.

New Zealand Securities Amendment Act 1988. The purpose for attribution in *Bilta*, however, involved at least two substantive rules, including s 213 Companies Act 2006 (UK), from which the breach of duty arose, and the illegality defence. Under either Lord Sumption's or the majority's approach, attribution in *Bilta* depended on the analysis of all of these contextual concerns. The clear advantage of this is that attribution will better reflect all the underlying policies of the case, and thereby ensure that attribution is appropriate on the facts.

Chapter III: The Practical Justifications

A. Introduction

This chapter demonstrates the practical benefits obtained through allowing attribution to pivot on the context of the case. It focuses on two cases which attempted to apply a presumption of attribution which was then negated under the fraud exception. It will be shown that the approach failed to take into account the context of the case and ultimately resulted in unsatisfactory reasoning. The first case, *Stone & Rolls*, highlights the difficulties in attempting to apply a mechanical framework of exceptions. In the second case, *Safeway Stores Ltd v Twigger*,⁹¹ the Court erroneously viewed a company as a wrongdoer for all purposes and without regard to the nature of the claim. This is problematic on both the orthodox application of the fraud exception, and on Lord Sumption's contextual formulation.

B. *Stone & Rolls Ltd v Moore Stephens*

Stone & Rolls was a one-person company with Mr Stojevic being the sole shareholder and director.⁹² The company was used as a vehicle for defrauding banks through presenting false documents in order to borrow funds which were subsequently transferred to other parties involved in the fraud. On discovering the fraud, the bank successfully brought a claim against Mr Stojevic and *Stone & Rolls* for deceit.⁹³ In attempting to recoup their losses, the liquidators for *Stone & Rolls* sued Moore Stephens, the company's auditors, for a breach of duty by failing to detect the fraud. Moore Stephens applied for a strike-out application on the basis that Mr Stojevic's fraud was attributed to *Stone & Rolls*, thereby barring the claim by virtue of the illegality defence.

The court held three⁹⁴ to two⁹⁵ that *Stone & Rolls* was unable to sue Moore Stephens. This conclusion was the result of five separate judgments that often conflicted on important points. This led the Court in *Bilta* to regard *Stone & Rolls* "as a case which has no majority ratio decidendi"⁹⁶ or at least one of very limited application.⁹⁷ It is submitted that the complicated nature of the case was a result of the Court's approach to attribution. In line with the above analysis, it will be submitted that attribution must turn on the context of the case and is unable to be answered through an appeal to mechanical exceptions. However, the House of Lords in

⁹¹ *Safeway Stores Ltd v Twigger* [2010] EWCA Civ 1472, [2011] 2 All ER 841 [*Safeway*].

⁹² Compare Lord Scott at [116] who, unlike the other four Law Lords, questioned whether all the shares were actually beneficially owned by Mr Stojevic.

⁹³ *Komerčni Banka AS v Stone and Rolls Ltd* [2002] EWHC 2263, [2003] 1 Lloyd's Rep 383.

⁹⁴ Lord Phillips, Lord Walker and Lord Brown.

⁹⁵ Lord Scott and Lord Mance.

⁹⁶ *Bilta*, above n 2, at [154] per Lords Toulson and Hodge.

⁹⁷ At [24] per Lord Neuberger, [50] per Lord Mance and [80] per Lord Sumption.

Stone & Rolls failed to identify this. As such, the court (i) failed to address the core issue in the case, (ii) unduly relied on the concept of a directing mind and will, and (iii) failed to take a principled approach to attribution.

1 Failure to address the core issues in the case

The primary consideration in *Stone & Rolls*, and effectively what divided the judges, was determining the classes of innocent parties whose interests the auditor contract protects.⁹⁸ It has been widely recognised that the “majority in *Stone & Rolls* did not adequately address this question”.⁹⁹ In the case, there were no innocent shareholders, but there were unpaid creditors who had an interest in the outcome of the case. In line with shareholder primacy, the majority held that no duty was owed to creditors.¹⁰⁰ It followed that, in order to prevent Mr Stojevic from benefiting from his own fraud, attribution was necessary. Alternatively, if the obligations of the auditors shifted like directors’ duties as the company moved towards insolvency, then the audit contract would be seen as protecting the interests of creditors.¹⁰¹ As a result, attribution would occur on the policy ground that an innocent party should not be deprived of the right to claim against a negligent auditor.¹⁰²

Further contention arose on the facts of *Stone & Rolls* regarding the type of loss which an auditor’s duty protects against. If an auditor’s duty did not extend to creditors’ interests (which the majority either concluded or implied), in the case of a one-person company or where the shareholders unanimously perpetrated the fraud, arguably there could be no recoverable loss as the shareholders could be taken to have knowledge of fraud at all times.¹⁰³ Accordingly, the ingredients of the claim could not be established and the illegality defence would not arise.¹⁰⁴ Moreover, Lord Walker and Lord Phillips raised the issue of whether there was any loss at all, given that *Stone & Rolls* started with nothing and did not acquire anything legitimately.¹⁰⁵ Again, this argument was not fully considered.

⁹⁸ Peter Watts “Audit Contracts and Turpitude”, above n 40, at 14.

⁹⁹ Eilis Ferran “Corporate Attribution and the Directing Mind and Will”, above n 19, at 253; See also Watts “Audit Contracts and Turpitude”, above n 40; and Jennifer Payne, “Corporate Attribution and the Lessons of Meridian”, above n 19.

¹⁰⁰ This has been supported by Watts “Audit Contracts and Turpitude”, above n 40; and Watts, above n 32. It was also the approach taken in *Caparo Industries plc v Dickman* [1990] 2 AC 605 (HL), which was heavily cited in *Stone & Rolls*.

¹⁰¹ This argument has the support of Eilis Ferran “Corporate Attribution and the Directing Mind and Will”, above n 19, at 255; See also Jennifer Payne, “Corporate Attribution and the Lessons of Meridian”, above n 19, at 373; and *Stone & Rolls*, above n 37, at [265] per Lord Mance.

¹⁰² *Stone & Rolls*, above n 37, at [63] per Lord Phillips, [192] per Lord Walker, [203] per Lord Brown and [241] per Lord Mance; See also Watts, above n 32, at 166-167; and Chapter IV.

¹⁰³ David Halpern “*Stone & Rolls Ltd v Moore Stephens: An Unnecessary Tangle*” (2010) 73 MLR 487 at 492.

¹⁰⁴ Halpern, above n 103, at 492.

¹⁰⁵ *Stone & Rolls*, above n 37, at [5] per Lord Phillips and [171] per Lord Walker.

Finally, the Court had to consider the extent of potential liability for auditors. If the auditor's duty was to extend to creditors, the auditor would be exposed to indeterminate liability which would go beyond the value of the shareholders' funds and would protect the debt of gullible creditors.¹⁰⁶ On the other hand, it would be odd that insolvency could serve as a limitation on an auditor's liability if the scope of the duty was held to protect shareholders only.¹⁰⁷ These considerations must also be taken in light of competing economic factors where an auditor should be encouraged to undertake the auditing function, but at the same time remain adequately accountable for their services.¹⁰⁸

The aim of this part is not to evaluate each of these points to establish whether *Stone & Rolls* arrived at the right outcome. Rather, the point is to draw attention to the contextual concerns that affected the decision of attribution in *Stone & Rolls*. From the wide range of complex underlying issues, it is clear that the context was not susceptible to being placed in a framework where attribution could be presumed and then negated through exceptions which are not entirely sensitive to all the principles and policies of the case. However, this is exactly what the House of Lords attempted. As a result, the Court undertook what Lord Hoffmann warned against in *Meridian* by "distracting attention from the purpose" of attribution,¹⁰⁹ and left "unsightly dents in some aspects of company law and agency law".¹¹⁰ The following parts of this section will explore how the House of Lords erred in its method for attribution.

2 *Undue reliance on the "directing mind and will"*

In *Stone & Rolls*, Mr Stojevic was the sole director and controller of the company. As such, he could undoubtedly be described as the "directing mind and will". In Chapters I and II it was argued that this description, however accurate, should not be used as a substantial basis for attribution as it wrongly assumes that the acts of an identified person are the acts of the company, without paying regard to context. Despite this, some members of the Court in *Stone & Rolls* relied on this concept, which caused it to slip into the anthropomorphic logic that the test often advances.

This reasoning is perhaps best seen in Lord Walker's judgment where Mr Stojevic was seen as the "embodiment of S & R for all purposes"¹¹¹ and "very ego and the centre of the personality of the corporation".¹¹² Lord Walker's remarks were echoed by Lord Brown who held that "Mr

¹⁰⁶ Peter Watts "Audit Contracts and Turpitude", above n 40, at 15.

¹⁰⁷ Eilis Ferran "Corporate Attribution and the Directing Mind and Will", above n 19, at 253; See also Ernest Lim, above n 24, at 342.

¹⁰⁸ Eilis Ferran "Corporate Attribution and the Directing Mind and Will", above n 19, at 256.

¹⁰⁹ *Meridian*, above n 1, at 509.

¹¹⁰ Peter Watts "Audit Contracts and Turpitude", above n 40, at 14.

¹¹¹ *Stone & Rolls*, above n 37, at [135] per Lord Walker.

¹¹² At [134] per Lord Walker.

Stojevic and [Stone & Rolls] were in effect one and the same person. It is absurd to describe Mr Stojevic as the agent and [Stone & Rolls] as the principal for all the world”.¹¹³ Lord Brown then went on to cite, with approval, Lord Reid’s statement in *Tesco Supermarkets Ltd v Natrass* where it was stated that “his mind is the mind of the company. If it is a guilty mind then that guilt is the guilt of the company.”¹¹⁴

It is conceded that the “directing mind and will” test was attractive in *Stone & Rolls* as Mr Stojevic was the only possible person from which attribution could arise. However, a convenient test should not replace a more principled approach. As recognised in *Bilta*, it does not follow from the fact that the fraud *could* be attributed that it *should* be. The failure to identify the context before attribution, in this case, led to the fallacy that a one-person company is automatically attributed with the one-person’s actions or state of mind and treated as fraudulent itself.

3 Failure to take a principled approach to attribution

As Mr Stojevic’s fraud was presumed to be that of Stone & Rolls, it was necessary to respond to the fraud exception which, on its face, would suggest the presumption be rebutted and the fraud not attributed. Clearly influenced by the fact that Stone & Rolls was a one-person company, the Court undertook backward reasoning to arrive at a non-absurd outcome. This involved either creating an exception to the fraud exception,¹¹⁵ holding that the fraud exception had no application,¹¹⁶ or concluding the case on other grounds.¹¹⁷

In particular, Lord Walker’s reasoning is a prime example of the dangers of implementing a structure of presumptions and exceptions. After reviewing the authorities on the fraud exception, he concluded that the fraud exception “can apply to any issue as to a company’s notice, knowledge or complicity, whether that issue arises as a matter of claim or defence”.¹¹⁸ In other words, Lord Walker did not consider the exception to depend on the particular context of the case. It should be noted that this is much more restrictive than even Lord Sumption’s exception in *Bilta*.

¹¹³ *Stone & Rolls*, above n 37, at [199] per Lord Brown.

¹¹⁴ *Tesco Supermarkets Ltd v Natrass* [1972] AC 153 (HL) at 170.

¹¹⁵ At [157]-[168] per Lord Walker. Lord Brown considered that the fraud exception did not apply, but in obiter stated at [200] that if it did, the sole actor exception would be appropriate.

¹¹⁶ Lord Phillips and Lord Brown.

¹¹⁷ Lord Scott is an exception to the other judges as he did not consider Stone & Rolls a one-person company (at [116]). As such, he was able to apply the fraud exception and conclude that the attribution should not occur in order to protect the innocent shareholders. Similarly, Lord Mance considered the interests of creditors in concluding that the fraud exception could apply (at [265]). Neither judge found the sole-actor argument compelling in the context.

¹¹⁸ At [145].

On Lord Walker’s formulation of the fraud exception, the presence of fraud prevented attribution. Displeased with this result, Lord Walker resorted to case law from the United States to support the establishment of a “sole actor” exception to the fraud exception.¹¹⁹ Lord Walker believed that this was necessary to “serve the ends of justice”.¹²⁰ Through the application of the fraud exception and then the respective “sole-actor” exception, Lord Walker concluded that Mr Stojevic’s fraud could not be attributed to Stone & Rolls.¹²¹

Respectfully, this reasoning is problematic. Lord Walker implies throughout his judgment that these exceptions are not context specific and can apply whenever the particular characteristic of the exception is present. This is not reconcilable with *Bilta* which was also effectively a one-person company. Extending Lord Walker’s reasoning to the facts of *Bilta*, the fraud exception would prevent attribution of the directors’ fraud, but the sole actor exception would then negate this exception and allow attribution. This would result in *Bilta* being attributed with the fraud of the directors and therefore being unable to sue those directors for a breach of duty.

This absurd result leads to the conclusion that the appropriate method of attribution must be sensitive to the underlying context of the case. This lends support to the contextual approach taken in *Bilta*. If the reasoning of the majority from *Bilta* was applied, the House of Lords in *Stone & Rolls* would have first analysed the context of the case before considering the question of attribution. This would have likely resulted in a free and open discussion of the context of the case, without the need to frame it through any respective exceptions or exceptions upon exceptions. As such, the method of attribution would not have distracted the Court from the true context and purpose for attribution, and would therefore have likely resulted in a more coherent and less complicated judgment. It is recognised that this was not necessarily the fault of the Court, which was bound to respond to the case submitted before it and was “handed the wrong tools to answer the question posed”.¹²²

C. *Safeway Stores Ltd v Twigger*

In *Safeway* a number of employees and directors repeatedly exchanged commercially sensitive retail pricing intentions with other, larger supermarkets and dairy processors. This increased the price of milk and other dairy products. The additional profits were then passed back to the farmers. This conduct resulted in a breach of s 2(1) of the Competition Act 1998 which prohibits anti-competitive behaviour between undertakings. The breach was conceded by Safeway. As a result, it was not necessary to establish that the misconduct was attributed to Safeway. In attempting to recoup the penalty, Safeway proceeded to bring a claim against the

¹¹⁹ At [157]-[168].

¹²⁰ At [159].

¹²¹ At [168].

¹²² Peter Watts “Audit Contracts and Turpitude”, above n 40, at 14.

rogue directors and employees for a breach of contract and/or fiduciary duties. The question for the Court of Appeal was whether to strike-out the claim against the directors on the basis that the breach of duty could be attributed to Safeway, causing the company to be caught by the illegality defence.

The complicating factor in the case was that the Competition Act states that a penalty may only be imposed if it “has been committed intentionally or negligently by the undertaking”.¹²³ Since liability was conceded under the Act, Safeway fell into this description. As a result, the Court held that Safeway’s liability was “not a vicarious one”¹²⁴ but rather the company was “personally liable” since “[Safeway] itself has intentionally or negligently committed the infringement”.¹²⁵ Lord Justice Longmore then went on to strike out Safeway’s claim against the directors and employees by stating that:¹²⁶

... once the maxim is engaged, [Safeway] cannot say that it was not personally at fault in order to defeat the application of the maxim. The whole hypothesis of the undertaking’s liability is that it is personally at fault.

Two points can be extracted from this reasoning. First, the company was being treated as a real person who *actually* partook in the anti-competitive action itself. As was emphasised in both Chapters I and II, this is not the correct position in law. Rather, the better way to view Safeway in this situation would be as a *deemed* wrongdoer by virtue of the directors’ misconduct for the purposes of the Competition Act only. It is likely Longmore LJ’s anthropomorphic reasoning was caused by a misunderstanding of agency law principles as it was held that “to talk of liability for the acts of one’s agents is to talk of vicarious liability and the company’s liability is not vicarious”.¹²⁷ As pointed out by Professor Peter Watts, Longmore LJ erred in this conclusion as agency generally does result in a direct obligation on the party of the owner of the undertaking.¹²⁸ Further, Watts considered that it was almost certainly in the law of agency that the Competition Act 1998 was intended to operate.¹²⁹

The second point follows where Longmore LJ’s description of the company as an actual wrongdoer prevented him from taking into account the context of the specific claim. This is evidenced by the conclusion that Safeway “cannot invoke the [fraud exception] to say that they were not ‘truly’ liable”.¹³⁰ As such, Safeway was unable to sue the directors and employees as

¹²³ Competition Act 1998 (UK), s 31(3).

¹²⁴ At [20].

¹²⁵ At [23].

¹²⁶ At [23].

¹²⁷ At [27].

¹²⁸ Watts “Illegality and Agency Law”, above n 88, at 220.

¹²⁹ At 220.

¹³⁰ At [29].

it was caught by the illegality defence. This reasoning is founded on the incorrect assumption that liability in one context results in a corresponding application of the result in a different context. If this were true, in any case where a company is found liable under a statute, it would necessarily follow that the illegality defence would preclude the company bringing a claim against the directors. It is clear from *Bilta* that this is not the case. Accordingly, a distinction must be drawn between (i) the claim against the company for the anti-competitive behaviour and (ii) the claim against the directors and employees by the company. Although the wrongdoing may be attributed in the former, contrary to Longmore LJ's reasoning, attribution in the latter does not automatically follow. This is true even though Safeway would be required to rely on liability under the first claim in order to bring the second.¹³¹ Indeed, this exact reasoning was applied in *Bilta* to allow the company to pursue the directors despite the company's liability to HMRC.

From this analysis, the problem with Lord Sumption's method of attribution in *Bilta* is apparent. Although a contextual fraud exception *could* be applied to rebut a presumption on the specific facts, like in *Safeway*, the presumption may cause the court to treat the company as a presumed wrongdoer for all purposes and therefore not give the context the attention it requires. With respect, this potential for confusion leading to unsatisfactory reasoning clearly indicates why the majority's approach is preferable to that of Lord Sumption.

Despite the flaws in Longmore LJ's reasoning, it does not follow that the result in *Safeway* would be any different. It is possible that the correct result was achieved through incorrect reasoning and, respectfully, the ultimate outcome was not as "startling" as Watts has previously made out.¹³² In determining whether to attribute the directors' and employees' wrongdoing to either allow or preclude the company pursuing the directors, in light of *Bilta*, the context must be examined.¹³³ To Pill LJ's merit, who gave a concurring judgment, it was stated that the "policy of the [Competition Act] would be undermined if undertakings were able to pass on the liability to the employees" or to the directors.¹³⁴ On this reasoning, Pill LJ viewed the refusal to attribute as justifiable. Whether or not this is a convincing enough reason to attribute the misconduct in order to engage the illegality defence, it is at least arguable that the company should have been prevented from claiming against its directors. This even led Lord Sumption in *Bilta* to state that it "would take a great deal of persuading that the Court of Appeal did not arrive at the correct conclusion in [*Safeway*]"¹³⁵.

¹³¹ *Bilta*, above n 2, at [43] per Lord Mance.

¹³² Watts "Illegality and Agency Law", above n 88, at 219.

¹³³ *Bilta*, above n 2, at [9] per Lord Neuberger, [44] per Lord Mance and at [191] per Lords Toulson and Hodge.

¹³⁴ *Safeway*, above n 91, at [44]. It is conceded that Longmore LJ also recognised this concern at [29], but it did not form part of the reasoning for attributing the wrongdoing to Safeway.

¹³⁵ At [31].

Nevertheless, there are at least three strong policy considerations not mentioned in the case that indicate why the company should not be attributed with the breach of duty in this context. First, and most importantly, the claim against the directors and employees should not be seen as passing on the liability, but rather as the company vindicating its rights against those directors and employees who were the “very cause of the liability in the first place”.¹³⁶ If the reasoning in *Safeway* was followed, the company would have no recourse against the employees or directors who participated in “morally reprehensible” anti-competitive behaviour.¹³⁷ It is unlikely that they could even be dismissed.¹³⁸ This is an unacceptable result, especially if the directors or employees obtained a personal benefit from the price fixing,¹³⁹ or if the behaviour caused a substantial loss to creditors during insolvency.¹⁴⁰ Furthermore, such a conclusion would contradict *Bilta* where the primary concern was upholding the enforceability of directors’ duties.¹⁴¹ Second, it would be odd to prevent Safeway from passing on liability to the employees or officers, when the alternative is for the company to pass on that cost to the consumer in order to recoup the penalty.¹⁴² Finally, the Competition Act does not preclude a company from claiming for remedies resulting from a breach of its directors’ duties under the common law or the Companies Act. If the intention of the Competition Act was to override these established remedies, it should have been clearly spelt out.¹⁴³

Regardless of whether the correct decision was reached in *Safeway*, it is clear that attribution in the case was contingent on the context first being ascertained. Where there are competing policy objectives at play, it is only through a detailed analysis of the facts that a principled decision on whether to attribute can be made. It is an unfortunate reality that Longmore LJ, when presented with the opportunity to do exactly that, resorted to metaphysical reasoning where the company was considered a wrongdoer for all purposes, irrespective of context. Although it is arguable that the right outcome may have been reached in *Safeway*, the failure to consider the full purpose for attribution removed any principled reasoning from the process.

On this conclusion, *Safeway* can be said to stand for a further point. The reasoning of Lords Toulson and Hodge in *Bilta* suggests that any case where a company seeks to sue its fraudulent director will not attract the illegality defence as it would be against public policy.¹⁴⁴ As such,

¹³⁶ Watts “Illegality and Agency Law”, above n 88, at 220.

¹³⁷ *Safeway Stores v Twigger* [2010] EWHC 11, [2010] 3 All ER 577 at [28].

¹³⁸ Watts “Illegality and Agency Law”, above n 88, at 219.

¹³⁹ It is unclear on the facts why the directors or employees wished to increase prices in order to pass the additional profits back to the farmers. One can only assume that the employees and directors indirectly benefited from this action.

¹⁴⁰ Ernest Lim, above n 24, at 344.

¹⁴¹ *Bilta*, above n 2, at [30] per Lord Neuberger, [42] per Lord Mance. [89] per Lord Sumption and [206] per Lords Toulson and Hodge.

¹⁴² Aidan Robertson “Pulling the Twigger: directors and employees back in the firing line for damages after Jetivia in the Supreme Court?” [2015] ECLR 325.

¹⁴³ Ernest Lim, above n 24 at 344.

¹⁴⁴ *Bilta*, above n 2, at [129] per Lords Toulson and Hodge.

an analysis of attribution in that situation would not be required. With respect, *Safeway* illustrates that this cannot be true and that attribution may still be at issue where the context, properly considered, demands attribution.¹⁴⁵ In *Safeway* this did not turn on just the policy of the Company's Act, but multiple other factors including the punitive nature of the Competition Act. Once this is understood, the majority's reasoning in *Bilta* gains traction where such cases are "concerned with attribution",¹⁴⁶ but where that inquiry is entirely dependent on the context of the case.

D. Conclusion

This chapter has provided practical examples of where the method of presuming attribution and then applying an exception based on fraud has generated unsatisfactory reasoning. First, *Stone & Rolls* acts as a good comparison to *Bilta* through the Court's reluctance to pay attention to the context of the case. As a result, the case was unnecessarily complicated and has been widely criticised for leaving gaps in the law. Second, *Safeway* demonstrates that the presumption of attribution has the potential to treat the company as an actual wrongdoer for all purposes. This fallacious reasoning shows the importance of (i) avoiding a presumption of attribution which may lead to anthropomorphism, and (ii) recognising all the policies for attribution in the case.

In applying the majority's approach to attribution from *Bilta*, it has been illustrated how the problems identified in these two cases could be resolved. In particular, the open discussion of the context allows the court to adopt a common-sense and merits based approach to properly address the complexities in each case. Although this relies on the judiciary undertaking a full and transparent analysis on the facts, it is submitted that this simply reflects this complicated area of law which cannot be reduced to mere presumptions and exceptions.

¹⁴⁵ In fairness, Lords Toulson and Hodge justified their approach on public policy at [129]. Therefore, it may have been possible to weigh competing policies in the case. However, this would only be in order to decide whether the illegality principle would apply. If it was found that it should (as Pill LJ in *Safeway* did), attribution would still be required. In this situation, attribution would still be contextual taking into account the policy concerns which influence the illegality defence. It is noted that a case-by-case application of the illegality defence was fiercely contested by Lord Sumption at [99] but seemingly approved by the court in *Patel* at [101] per Lord Toulson.

¹⁴⁶ *Bilta*, above n 2, at [15] per Lord Neuberger.

Chapter IV: The Theoretical Justifications

A. Introduction

In Chapter II, the contextual approach articulated by the majority in *Bilta* was submitted as being correct. This claim was supported in Chapter III where two problematic cases were analysed in light of *Bilta*. These cases showed how attribution will turn on the specific facts and policies of the individual case. Moreover, any attempt to apply a presumption of attribution that can be rebutted through certain exceptions is likely to lead to anthropomorphic reasoning or a complicated process which may distract from the true issues in the case. In comparison, it was argued that a contextual approach would allow the court to openly consider the nature of the claim before determining the issue of attribution, which will likely lead to a more principled result. It follows from these conclusions that the presumptive and exception-based method of attribution should be abandoned.

Nevertheless, it does not follow that all the case law relating to the exception must also be discarded. It is submitted that the previous application of the fraud exception is useful for two reasons. First, valuable contextual considerations can be extracted from the cases that should be taken into account when deciding whether to attribute a director's fraud to a company. Second, it will be shown that there is no theoretical justification that can support the application of a general exception to attribution. In doing so, this argument provides support for the approach endorsed in *Bilta* which allows attribution to turn on the context of the case.

This discussion will be framed in reference to the three distinct circumstances mentioned throughout this paper. These are: (i) where a third party brings a claim against the company for loss suffered by that third party, (ii) where the company brings a claim against the rogue director for a breach of duty, and (iii) where the company brings a claim against a third party in relation to the loss suffered by the company.

B. Third Party v Company

In the context of a third party suing a company, the attribution of a director's fraud may be relevant if the company seeks to disown that fraud in an attempt to escape liability for loss which is a consequence of the fraud. In civil cases, such liability may arise from contract, tort, or statute and will primarily be settled through the established rules of agency.¹⁴⁷ A classic example of a case within this category is when the revenue department brings a claim against a company for a tax liability incurred as a result of the director's fraud.¹⁴⁸ This situation does

¹⁴⁷ Watts and Reynolds (eds) *Bowstead & Reynolds on Agency*, above n 19, at 396.

¹⁴⁸ For example, see *Moulin Global Eyecare*, above n 46.

not raise the illegality defence as the company has no action which could be barred, but rather is responding to a claim by the third party.¹⁴⁹

In these cases, which have been termed the “liability cases”,¹⁵⁰ it is common to consider the company a neutral party¹⁵¹ or a perpetrator of the fraud,¹⁵² as opposed to a victim of the fraud.¹⁵³ This metaphor, although instinctive, should not be extended too far and is limited in application. Much like the “directing mind and will”, referring to a company as a “victim” or “wrongdoer” gives the impression that the company itself has acted, rather than its agents. This may lead a court, like in *Safeway*, to conclude that the company is a wrongdoer or victim for all purposes, regardless of context. Furthermore, the notion that a company is a “perpetrator of the fraud” is complicated when the company also suffered loss through the fraud, despite not being the primary victim. This means that the company would technically be considered a “secondary victim”.¹⁵⁴ In this situation, where a third party claims against a company, the company is conceivably both a victim and a perpetrator of the fraud.

Nevertheless, the analogy reflects the interests that have typically been prioritised in this context. If the fraud was not to be attributed to the company, the innocent third party would be prevented from bringing a claim against the company as the company would not be deemed liable. This would mean that liability could never be imposed on the company, and would leave the aggrieved third party without any recourse against the company.¹⁵⁵ In order to rectify this situation, the judiciary ensures that the onus of loss does not lie on the innocent third party, but on the company which will “suffer through the actions of its own directors”.¹⁵⁶ This conclusion can be further justified by not creating a perverse economic incentive for third parties to contract with a company when the fraud exception would deny them the basic right to sue the company for a breach of duty owed to them.¹⁵⁷ Parliament has also recognised these concerns by including an expansion of the indoor management rule within the Companies Act 1993 to protect third parties dealing with the company.¹⁵⁸ On these grounds, it makes no difference whether the company is a one-person company or not as it is the third party’s interests being prioritised and not the company’s.¹⁵⁹

¹⁴⁹ *Bilta*, above n 2, at [88] per Lord Sumption.

¹⁵⁰ *Bilta (UK) Ltd (in liquidation) and others v Nazir and others* [2013] EWCA Civ 968, [2014] 1 All ER 168 at [34].

¹⁵¹ *McNicholas Construction Co Ltd*, above n 46, at [55].

¹⁵² *Bilta*, above n 2, at [208] per Lords Toulson and Hodge.

¹⁵³ Compare *Belmont*, above n 46; and *Arab Bank plc v Zurich Insurance Co* [1999] 1 Lloyd’s LR 262 (QB) at 282.

¹⁵⁴ See *McNicholas Construction Co Ltd*, above n 46.

¹⁵⁵ *Morris v Bank of India* [2005] EWCA Civ 693, [2005] 2 BCLC 328 at [114].

¹⁵⁶ *Bilta (UK) Ltd (in liquidation) and others v Nazir and others*, above n 150, at [34].

¹⁵⁷ Lim “Attribution in Company Law” (2014) 77 MLR 794 at 802.

¹⁵⁸ See generally Companies Act 1993, Part 3.

¹⁵⁹ See *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC) at 393.

It should be noted that none of the early cases on the fraud exception contemplated using it as a mechanism to avoid liability by a third party. Lord Walker's analysis in *Stone & Rolls* appears to be the only authority which makes an attempt to extend the fraud exception to this context.¹⁶⁰ This reasoning was later retracted in *Moulin* where Lord Walker himself stated "I now see that I was wrong... to regard the fraud exception as being of general application, regardless of the nature of the proceedings".¹⁶¹ For the most part, the context of a third party suing a company has been dealt with successfully in a wide range of cases, including those that have discussed the fraud exception.¹⁶²

C. *Company v Director*

A claim by a company against a director was the subject matter of *Bilta* where it was firmly held that a director's fraud would not be attributed to the company for the purpose of insulating that director against the liability from the company. This situation has been recognised as the paradigm example in which a director's fraud should not be attributed to the company.¹⁶³ The weight of authority recognises the absurdities that would arise if this was not the case.¹⁶⁴

In this context, it is possible to conceive of the company as a "victim" of the fraud as the company will likely be able to prove loss in the claim against its director.¹⁶⁵ Despite this, it is again submitted that this is not the most appropriate basis on which the decision to attribute rests. The "elusive" distinction between a primary and second victimhood would likely still cause confusion in the courts and should be avoided.¹⁶⁶ This is particularly true where the net effect of the fraud was neutral or even beneficial to the claimant company. Rather, it is more appropriate to recognise that this context demands that the company be able to vindicate its rights against the director that are conferred upon it by statute or common law.¹⁶⁷ On this basis, the rationale behind the decision of whether to attribute is not contingent on the presence of fraud and can apply to "honest" breaches of duties by the director.¹⁶⁸ This must be correct if there is to be any enforceability of directors' duties.¹⁶⁹

¹⁶⁰ *Stone & Rolls*, above n 37, at [145].

¹⁶¹ *Moulin Global Eyecare*, above n 46, at [101].

¹⁶² See generally *Morris*, above n 155; *El Ajou*, above n 23; *Royal Brunei Airlines Sdn Bhd v Tan*, above n 159; *McNicholas Construction Co Ltd*, above n 46; and *Moulin Global Eyecare*, above n 46.

¹⁶³ P Watts and F Reynolds (eds) *Bowstead & Reynolds on Agency*, above n 19, at 550.

¹⁶⁴ See generally *Re Fitzroy Bessmer Steel Co Ltd* (1884) 50 LT 144 (Ch); *Belmont*, above n 46; *Nationwide Building Society v Dunlop Haywards Ltd* [2007] EWHC 1374 (Comm), [2007] All ER 393; *Moulin Global Eyecare*, above n 46, at [106]; and *JSC BTA Bank v Ablyazov* [2013] EWHC 510 (Comm), [2013] All ER 176, at [166].

¹⁶⁵ For an example see *Belmont*, above n 46, at 261.

¹⁶⁶ *Bilta*, above n 2, at [93].

¹⁶⁷ Peter Watts "Audit Contracts and Turpitude", above n 40, at 19.

¹⁶⁸ P Watts and F Reynolds (eds) *Bowstead & Reynolds on Agency*, above n 19, at 550.

¹⁶⁹ It is at least arguable that this reasoning should have been applied in *Safeway*. See generally Watts "Illegality and Agency Law", above n 88, at 220.

This reasoning is applicable even if the fraud had been endorsed by resolution at a formal board meeting and completed under the company's seal. Although this would seem like a decision of the company under the primary rules of attribution, it still would not follow that the company would automatically be attributed with the fraud for all purposes. As illustrated by *Safeway* in Chapter III, attribution in each context will turn on its own facts. An example of this arose in *Belmont Finance Corporation Ltd v Williams Furniture Ltd*¹⁷⁰ where it was alleged that the directors of Belmont, acting as the Board,¹⁷¹ had conspired to use the company's funds to purchase shares in another company, Maximum, for an excessive price. The shareholders of Maximum then purchased all the shares in Belmont. This had the effect of giving unlawful financial assistance to the shareholders of Maximum to acquire shares in Belmont from its parent company. This was a breach of fiduciary duty and a criminal contravention of s 54 Companies Act 1948. The receiver for Belmont subsequently brought proceedings against the fraudulent directors for a breach of duty, but was met with the illegality defence. Buckley LJ rejected the defence and held that the company was not attributed with the director's knowledge that the asset was over-priced on the basis that "the essence of the arrangement was to deprive the company improperly of a large part of its assets".¹⁷² As such, "it would be irrational to treat the directors, who were allegedly parties to the conspiracy, notionally as having transmitted this knowledge to the company".¹⁷³ The enforceability of directors' duties and the separate legal identity of the company were the clear contextual concerns in that case.

Similarly, it would make no difference to the analysis if the company was a one-person company, where the wrongdoing was committed by the sole shareholder and director, or where the shareholders and directors were all privy to the fraud.¹⁷⁴ In such cases, the exact same concerns apply where automatic attribution would not be sensitive to the context and would not hold the directors accountable. This reasoning was applied in *Bilta* to reject any notion of presumptive rules or exceptions for a one-person company in this context.¹⁷⁵

Once the above discussion is understood, it becomes apparent that any form of "exception" is not required, but rather a recognition that this specific context does not require attribution to arise at all. It is conceded that an argument exists where a "breach of duty exception" could be

¹⁷⁰ *Belmont*, above n 46.

¹⁷¹ *Belmont Finance Corporation Ltd v Williams Furniture Ltd* [1980] 1 All ER 393 (CA) [*Belmont* 2]. The fact that it was a board decision only came clear when the case was re-heard.

¹⁷² *Belmont*, above n 46, at 261.

¹⁷³ *Belmont*, above n 46, at 261.

¹⁷⁴ This is true at least where the company is insolvent so that there can be no question of a valid ratification of the breach: *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) at 250. Practically speaking, this would almost never be an issue in a solvent one-person company, as the fraudster would not bring a claim against him or herself for a breach of duty.

¹⁷⁵ *Bilta*, above n 2, at [42] per Lord Mance, [90] per Lord Sumption and [200] per Lords Toulson & Hodge; See also *RBG Resources plc v Rastogi* [2002] EWHC 2782 (Ch), [2002] All ER 343.

formulated,¹⁷⁶ however this would suggest that the only time the fraud would not be attributed was where a company attempts to sue its director. As will be explored in the following part, this is incorrect.¹⁷⁷

D. Company v Third Party

The context of the company bringing a claim against a third party is considerably more complicated than the previous two situations. This is because attribution not only turns on the nature of the claim itself, but also on the structure of the company bringing the claim.

1 The nature of the claim

Under the umbrella of “company v third party”, it is necessary to separate two distinct categories of cases. First, a company may bring a claim against a “dishonest” third party who was directly involved in the fraud undertaken by its own directors. Cases of this nature include claims for knowing receipt, dishonest assistance or conspiracy. The second category, on the other hand, involves the company suing an “honest” party who was not privy to the fraud, but nevertheless had some sort of duty to protect or indemnify against it. In both categories, it will be contended by the third party that the director’s fraud is attributable to the company, thus precluding the company from bringing the claim against the third party through the illegality defence.

(a) Dishonest third parties

In the first category, the courts have generally been unreceptive to the idea that a party to the fraud can be in a better position than the director who committed the fraud.¹⁷⁸ If the company was attributed with the fraud in this context, it would ultimately mean that the dishonest third party could never be held civilly liable.¹⁷⁹ This is clearly an undesirable outcome and was recognised in *Bilta* where Jetivia, the co-defendant to the directors, was considered to be in the same position as the fraudulent directors, despite owing no duty to the company.¹⁸⁰

While the application of the fraud exception on this basis would seem desirable, it would not be accurate. Like in the situation of the company claiming against its directors, a claim for knowing receipt or dishonest assistance does not hinge on the fraud of the director. An honest

¹⁷⁶ This terminology was utilised by Lord Sumption in *Bilta*, above n 2, at [71].

¹⁷⁷ Compare *Moulin Global Eyecare*, above n 46, at [80] per Lord Walker where it was observed that some would say that this context is the only context in which the fraud exception should apply.

¹⁷⁸ See generally *J C Houghton & Co v Nothard, Lowe & Wills Ltd* [1928] AC 1.

¹⁷⁹ *Watts*, above n 42, at 316.

¹⁸⁰ *Bilta*, above n 2, at [95] per Lord Sumption and [175] per Lords Toulson and Hodge.

breach of duty by the director is sufficient to raise the claim.¹⁸¹ An exception based on “fraud” is therefore incorrect and is too narrow to allow a company to fully vindicate its claim against a dishonest third party.¹⁸² It is therefore submitted that rather than directing attention towards the fraud of the director, the courts should be willing to recognise that this is simply another instance that attribution does not arise, based on the policy that a dishonest third party must be able to be held accountable for its dishonest acts.

(b) Honest third parties

The second category of cases is distinct on the basis that the parties voluntarily entered into an agreement to protect or indemnify against fraud, rather than liability being imposed upon them. Examples include an auditor or insurance contract. In such cases, the issue before the courts is one of construction by ascertaining the scope of the duty or obligation that the third party owes to the company.¹⁸³

In the context of a disclosure for an insurance contract, the courts have not been prepared to attribute the fraud of a director to the company, at least where the company is not a one-person company. This reasoning can clearly be seen in the obiter dictum of Staughton LJ in *PCW Syndicates v PCW Reinsurers* where the fraud exception was seen to “extend to any case where the principal’s rights are affected” by the director’s fraud.¹⁸⁴ Similarly, Rix LJ in *Arab Bank Plc v Zurich Insurance Co* relied on the fraud exception to hold that:¹⁸⁵

a director’s knowledge is not to be attributed to his company, whether as the knowledge of the company itself, or as the knowledge which in the ordinary course of business that company is to be inferred or deemed to know, to the extent that his knowledge is of his own acting in fraud of the company.

This reasoning has been mirrored in similar cases, such as that involving audit contracts. In *Stone & Rolls*, all the Law Lords considered that it was at least arguable that the fraud exception would apply in the case where there are innocent shareholders.¹⁸⁶ Similarly, in *Duke Group Ltd v Pilmer* the attribution of a director’s fraud was considered inappropriate in relation to a claim against a negligent accountant by a company, which was not a one-person company.¹⁸⁷

¹⁸¹ *Royal Brunei Airlines Sdn Bhd v Tan*, above n 159, at 392. See also *El-Ajou v Dollar Land Holdings*, above n 23, at 700.

¹⁸² Watts, above n 42, at 318.

¹⁸³ Watts, above n 42, at 325.

¹⁸⁴ *PCW Syndicates*, above n 87, at 256.

¹⁸⁵ *Arab Bank Plc*, above n 153, at 282.

¹⁸⁶ *Stone & Rolls*, above n 37, at [63] per Lord Phillips, [192] per Lord Walker, [203] per Lord Brown and [241] per Lord Mance.

¹⁸⁷ *Duke Group Ltd v Pilmer* [1999] SASC 97, (1999) 73 SASR 64 at [616]-[652].

While the “victim” rationale has arisen in this context also,¹⁸⁸ in line with the previous two circumstances, it is submitted that this is not a proper justification for the fraud exception. In this case, the company is simply suing the third party for the very thing that the third party undertook, but failed to do. If the company was attributed with the fraud in this context, it would lead to the absurd result that the third party would be able to provide a service but could never be held accountable if that service was done negligently or in breach of contract.

2 *One-person company*

Unlike in the context of a third party suing the company, or the company suing a director, the structure of a company can be pivotal to attribution when the company seeks to sue a third party. In *Berg, Sons & Co Ltd v Mervyn Hampton Adams*, it was held that a one-person company involves no individual concerned in its management and ownership other than those who are aware of the fraud.¹⁸⁹ As such, a one-person company is capable of having more than one person, provided that everyone is complicit in the fraud. The paradigm example of a one-person company, nevertheless, is where the company has a sole director and shareholder with no creditors and where no innocent parties have a beneficial interest in any of the company’s property. By holding that the interests of the creditors were not relevant, the majority in *Stone & Rolls* considered that the company in that case fit squarely within this definition.¹⁹⁰ In such cases, the company is only being used as a façade to separate the one-person from their fraud. It is well established that, where incorporation is used in this manner, the corporate veil can be lifted so that the company can be equated with the one-person.¹⁹¹

In reference to the majority in *Stone & Rolls*, this result has been noted as an example of the reverse piercing of the corporate veil, where the separate legal identity of the company was set aside “not for the purpose of suing him, but in order to attribute his knowledge to the company” so that the third party can raise the illegality defence against the company.¹⁹² This recognises the policy underlying the illegality defence that incorporation should not be capable of being used by the one-person as a method of profiting from fraud.¹⁹³ It follows that in this context attribution will likely occur, even where the third party was privy to the fraud or in breach of their duty owed to the company.¹⁹⁴

¹⁸⁸ *Arab Bank Plc*, above n 153, at 282.

¹⁸⁹ *Berg, Sons & Co Ltd v Mervyn Hampton Adams* [1993] BCLC 1045 (QB) [*Berg*] at 1064; See also *Stone & Rolls*, above n 37, at [161].

¹⁹⁰ This can be compared to the dissenting judges who saw the auditor’s duties extending to protect creditors.

¹⁹¹ *Jones v Lipman* [1962] 1 WLR 832 (Ch); See also *Prest v Petrodel Resources Ltd* [2013] UKSC 34, [2013] 2 AC 415.

¹⁹² *Prest*, above n 191, at [95].

¹⁹³ Peter Watts “Audit Contracts and Turpitude”, above n 40, at 17.

¹⁹⁴ *Lim*, above n 157, at 805. Note that in *Duke Group Ltd*, above n 187, the fraud was still considered relevant to the issue of contributory negligence.

(a) Dishonest third parties

Despite the clear issues with allowing a one-person company to claim against a third party, there is authority to support the proposition that it can in some instances. The first case to this effect is *Brink's Mat v Noye*, where a company called Scadlynn was the recipient of gold that had been stolen from Brink's Mat.¹⁹⁵ Although the directors and sole shareholder of Scadlynn were all aware that the gold was stolen, they melted it down and sold it without Brink's Mat's consent. The proceeds from the sale were placed into Scadlynn's bank account and dispersed. After Scadlynn had entered liquidation, Brink's Mat argued that it was entitled to enforce Scadlynn's rights against the bank for knowing receipt. The issue for the court was whether the fraud of Scadlynn's directors could be attributed to the company in order to prevent Scadlynn from suing the bank. In holding that the fraud could not be attributed, Nicholls LJ stated that:¹⁹⁶

Scadlynn was being used as a vehicle for committing a fraud on its creditors and a fraud on those beneficially interested in property held by Scadlynn. In those circumstances the fraudulent purposes of those controlling Scadlynn are not to be imputed to the company itself.

The second case which maintains this position is *Bilta* itself. In relation to the co-conspirator, Jetivia, the court considered that the fraud would not be attributed to Bilta to insulate the third party for ancillary liability.¹⁹⁷ This conclusion was reached despite the fact that Bilta's two directors and sole shareholder all partook in the fraud. The reason for this decision is not entirely clear in any judgment.¹⁹⁸

Although not expressly stated in either case, it is submitted that these conclusions could only have been reached through recognising the interests of the innocent parties. In *Brink's Mat*, Scadlynn was acting as a constructive trustee for Brink's Mat, who was the innocent constituent. It is presumably this fact that led the court to conclude that Scadlynn was a "secondary victim"¹⁹⁹ with the result that the fraud could not be attributed. If there were no innocent parties, it is difficult to see how the company could, in any way, be considered a "victim".²⁰⁰ Similarly, in *Bilta*, innocent creditors had an interest in allowing the company to bring a claim against Jetivia as it would result in the recovery of money that could be used to repay debt. Throughout *Bilta* it was implicit that Jetivia was in the same position as the

¹⁹⁵ *Brink's Mat v Noye* [1991] 1 Bank LR 68 (CA).

¹⁹⁶ At 73.

¹⁹⁷ *Bilta*, above n 2, at [95] per Lord Sumption and [175] per Lords Toulson and Hodge.

¹⁹⁸ This is presumably because Jetivia was conceded to be in the same position as the directors: *Bilta*, above n 2, at [120].

¹⁹⁹ *Brink's Mat*, above n 195, at 73 per Nicholls LJ.

²⁰⁰ It could be argued that this is upholding the separate legal personality of the company. However, as above, where the company is being used solely as a vehicle for fraud, the separate legal personality can and should be set aside.

directors. Extending this reasoning, as the company was entitled to sue the directors for a breach of duty owed for the benefit of the creditors,²⁰¹ it follows that the company could also sue the dishonest third party for the benefit of the creditors.

It should be noted that the presence of innocent parties with an interest in the company makes it contestable whether the company still falls within the definition of a one-person company. Traditionally, a company is considered to consist only of the board of directors and the shareholders who together are the “organs” of the company.²⁰² However, in both *Brink’s Mat* and *Bilta*, the innocent parties do not fall within this description, but are nevertheless concerned with the fraudulent management of the company and therefore would likely satisfy the test of *Berg*.²⁰³ This discussion raises intriguing questions about the conceptual foundations of a company, particularly in regard to who can be considered an innocent party and how far the definition of the company can stretch. Due to the complex nature of this issue, it unfortunately falls outside the scope of this paper. Regardless of whether or not the company is considered a “one-person” company, the above two cases demonstrate that the courts will recognise and protect an innocent constituency’s interests against the dishonest third party by not attributing the fraud to the company to defeat their claim.

This outcome may be criticised for turning the company into a “mindless automation” as the company is left without a “directing mind and will”,²⁰⁴ but this critique is without merit. There is nothing in law to suggest that, at all times, a company must be attributed with the acts or knowledge of any person.²⁰⁵ Indeed, it would contradict the separate legal personality of the company if this were the case. Rather, it is submitted that this outcome is simply an instance of looking beyond the corporate veil in order to ascertain the true structure of the company on the policy ground that innocent parties must be given an avenue to claim against a third party who fraudulently affects their interests.²⁰⁶

(b) Honest third parties

As recognised above,²⁰⁷ in cases involving an honest third party, the question will be one of construction. This means the inquiry of whether the duty is owed beyond the fraudulent directors and shareholders to innocent parties outside the company will largely turn on the specific contract or tort. The complexities of this discussion were noted in the discussion of *Stone & Rolls* in Chapter III and need not be reiterated. If the duty is held to be for the benefit

²⁰¹ Companies Act 2006 (UK), s 172(3).

²⁰² Watson, above n 7, at 780.

²⁰³ See discussion above relating to footnote 189.

²⁰⁴ *Bilta*, above n 2, at [91] per Lord Sumption.

²⁰⁵ P Watts and F Reynolds (eds) *Bowstead & Reynolds on Agency*, above n 19, at 550-551.

²⁰⁶ Lim, above n 157, at 804.

²⁰⁷ See discussion above relating to footnote 183.

of shareholders only, like the majority opined in *Stone & Rolls*, and in line with the analysis above,²⁰⁸ attribution will likely occur.

Nevertheless, where the relevant duty owed by the third party to the company extends to protect innocent creditors and those beneficially interested in the company's property, like in the case of a dishonest third party, the same reasoning can be applied as if the company was not a one-person company. Accordingly, attribution will not occur so that the innocent constituencies can recover against the third party who undertook a duty to protect their interests. This reasoning was apparent in the minority judgments in *Stone & Rolls* where the innocent creditor's interests were prioritised in order to prevent attribution and allow the company to sue the negligent auditor. Consequently, where an honest third party breaches a duty owed to a one-person company which encompasses the nature and extent of the loss suffered by the company or its innocent constituents, there is no reason that the company should be attributed with the fraud, provided that the one-person does not benefit from the fraud.²⁰⁹

E. Conclusion

Through an analysis of the three general circumstances in which a director's fraud is relevant, it is clear that there is no common rationale for excluding attribution on the basis of fraud. Each context is independent and requires its own examination of the distinct policies underlying each case. It follows that a universal rule excluding attribution cannot be appropriate. Moreover, any attempt to apply rules of strict application will likely divert attention from the true purpose for attribution on the given facts. In light of this, it is better to recognise that, in some situations, attribution simply does not arise after a full consideration of the context.

Although the above discussion outlines the broad policy reasons for attribution in each case, these should be seen as nothing more than mere guidelines. Without a comprehensive analysis of the specific facts in each case, it is impossible to set concrete rules. Furthermore, like in *Safeway*, it is common for countervailing policy factors to cause the case to fall outside the paradigm examples of each circumstance. It is submitted that this is where the advantage of the majority's approach in *Bilta* is truly seen. Through a consideration of the context of the case as a whole, taking into account the different factors at play, the court is given the tools to arrive at a principled decision. It would be difficult for an approach reliant on exceptions to arrive at the same result. Even if it could, the reasoning in *Stone & Rolls* demonstrates that the case would likely be unnecessarily complicated.

²⁰⁸ See discussion above relating to footnotes 189-194.

²⁰⁹ Lim, above n 157, at 805. In respect of the one-person not benefiting from their fraud, there is scope for the principle established in *In re VGM Holdings Ltd* [1942] Ch 235 (CA) to be expanded: see generally Alan Sheeley and Mehmeht Karagoz "Fraudulent Directors and the Impact on Companies – Victims or Wrongdoers?" (2015) 1 Tur Com L Rev 125.

Conclusion

Although a company is autonomous in law, it is not autonomous in fact.²¹⁰ This raises issues regarding the appropriate method to attribute a person's acts or state of mind to the company. The difficulty of this process is particularly evident when it is the fraud of a director that is the question of attribution. Until recently, the courts have failed to provide a principled method in this setting.

Influenced by the directing mind and will test, the courts have often applied a presumption of attribution. As was evident in *Safeway*, this presumption can lead to the fallacious conclusion that a company is an actual wrongdoer itself and therefore attributed with the director's fraud for all purposes. This conclusion contradicts the separate legal personality of the company and does not allow attribution to adequately reflect the context of the case.

Faced with this presumption, the fraud exception was utilised to prevent attribution when the director committed fraud on the company. *Stone & Rolls* illustrates how such an approach will not result in acceptable reasoning where the exception applies irrespective of context. As seen in Lord Walker's judgment, it was necessary to fashion exceptions to the fraud exception in order to arrive at an appropriate outcome. This ultimately distracted from the real issues in the case and resulted in an unnecessarily complicated process. Furthermore, Chapter IV demonstrated that there is no theoretical basis for excluding attribution on the basis of fraud. Rather, in each of the identified situations, there are genuine policy concerns that should be considered in the decision to attribute. Attempting to bundle these into an exception based only on fraud will prevent the court from ascertaining the purpose for attribution.

In contrast to these concerns, the approach advanced by the majority in *Bilta* gives the court the tools to arrive at a principled decision regarding attribution. Analysing the context of the case without reliance on a presumption of attribution removes the danger of slipping into anthropomorphic reasoning. Similarly, by placing the context at the forefront of the analysis, the underlying policies of the case can be analysed without the need to frame the discussion through arbitrary exceptions. This is particularly true where, as in *Safeway*, there are many different policy concerns affecting the decision to attribute. Although the reasoning is dependent on the judiciary undertaking a full and transparent analysis of the case, this does not create any more uncertainty than the orthodox approach which, despite using terms such as "presumptions" and "exceptions", relies on exceptions upon exceptions to arrive at a desired outcome and is therefore incapable of providing a consistent result.

²¹⁰ *Bilta*, above n 2, at [66].

On this basis, the *Bilta* approach to attribution should be seen as bringing clarity and principle to the law. Being a decision from the United Kingdom's highest court, it is hopeful that future cases will recognise the benefits of this method. This paper also provides persuasive reasons why the *Bilta* approach should be followed in New Zealand, which is yet to consider the case. This is particularly attractive considering *Bilta* is an affirmation or extension of *Meridian*, a case appealed from New Zealand. In doing so, it would allow New Zealand to avoid the shortfalls of the presumptive and exception based method of attribution that this paper has identified.

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