. METAPHOR AND METAPHYSICS IN COMPANY LAW

Robert Walker

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A body corporate formed under the Companies Acts is sometimes referred to by a term used in Roman law, *persona ficta*, a fictitious or imaginary person. In truth it has, according to an old epigram that appears in several different forms,[1] no body to be burned and no soul to be damned. But any developed legal system has to work out how to fit these imaginary persons, with no bodies and no souls, into a legal order in which a person's liability under civil or criminal law often depends on that person's intentions or state of knowledge. Similarly any developed legal system has to decide how far those who control a company (whether those persons are individuals or, in the case of a subsidiary company, its holding company and the holding company's controllers) can be made concurrently responsible for a primary liability which cannot in practice be satisfactorily enforced against the company itself.

The first of these big issues is generally referred to as the issue of attribution: how far is the state of mind of a company's actual controller (or sometimes, the state of mind of some much less powerful agent of the company) to be attributed to the company itself for the purpose of determining its civil or criminal liability? The second big issue looks at the position the other way round – upstream instead of downstream, or *vice versa,* depending on which mental diagram you favour: if a company is subject to a liability which cannot be effectively enforced against it, when does the claimant have an alternative remedy against its controllers?

[1] See Gower and Davies, Principles of Modern Company Law, 9th ed (2012) para 2-10, fn 43

This second process is sometimes referred to as piercing the corporate veil, but I will say at once that this rather dramatic expression is in my view unhelpful. It is not an aid to legal analysis, and what is needed in this area is careful legal analysis conducted in, and guided by, the legal context in which the issue arises.

Metaphor and metaphysics are unlikely to assist. In the *Bolton Engineering* case[2], in the context of a corporate landlord's intention to occupy business premises. Denning LJ used language which could have been taken from Aesop's Fables:

> "A company may in many ways be likened to a human body. It has a brain and nerve centre which control what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will."

This anthropomorphic approach was disapproved by the House of Lords in *Tesco Supermakets Ltd v Natrass* [3] in 1971, and by the Privy Council in the very important *Meridian* case [4] in 1995. Lord Hoffmann's magisterial opinion in *Meridian*, anticipated to some extent by the decision of the Court of Appeal in *El Ajou*[5] the year before, displaced the canonical status of Viscount Haldane's famous pronouncement about a company's "directing mind and will" in the *Lennard's Carrying Company* case[6] eighty years before. In that case the issue was whether a loss of cargo had occurred without the "actual fault or privity " of the appellant company whose ship had gone aground after its engines failed because of poor maintenance.

Lord Hoffmann explained that Viscount Haldane's words were limited by the factual context:[7]

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[2] *Bolton Engineering Co Ltd v Graham & Sons Ltd* [1957] 1 QB 159, 172
[3] *Tesco Supermarkets Ltd v Natrass* [1972] AC 153
[4] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500
[5] *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685
[6] *Lennard's Carrying Company Ltd v Asiatic Petroleum Ltd* [1915] AC 705
[7] [1995] 2 AC 500, 509

> "Because [the Lennard company] does not seem to have done anything except own ships, there was no need to distinguish between the person who fulfilled the function of running the company's business in general and the person whose functions corresponded, in relation to the cause of the casualty, to those of an individual owner of a ship. They were one and the same person. It was this coincidence which left Viscount Haldane's speech open to the interpretation that he was expounding a general metaphysic of companies."

I commented on this in my judgment in a recent case[8] in the Court of Final Appeal of Hong Kong:

> "The rather belated recognition of this important qualification to the 'directing mind and will' concept considerably reduces its apparent force. Except in the case of very small companies with very simple activities, there will not be a single individual who satisfies the test for all purposes. After *Meridian* some legal scholars conjectured that the concept might disappear from company law, and it might be better if it had disappeared, as it tends to obscure the underlying importance of the basic principles of agency. To refer instead to 'the relevant responsible director or employee', or some such expression, would be less arresting but a good deal more accurate, especially in view of cases such as *Tesco Stores Ltd v Brent LBC*[9]

That case, decided in 1993 and not to be confused with *Tesco Supermarkets Ltd v Natrass,* shows how far the law had moved, at least in regulatory cases, even before *Meridian.* It was a prosecution of the supermarket company for selling an "18" rated video recording to a 14-year-old boy. There was a defence if the accused "neither knew nor had reasonable grounds to believe" that the boy was under 18. The main question for the Divisional Court, after a conviction before the Justices, was whether the relevant state of mind was that of the till attendant, a young woman who was probably paid less than one-hundredth of the pay and bonuses of the CEO. The Divisional Court held, dismissing the appeal, that the statutory defence "refers to the knowledge and information of the employee through whom the company effects a supply."

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[8] *Moulin Global Eyecare Trading Ltd v Commissioner of Inland Revenue* (2014) 17 HKCFAR 218, 251

[9] [1993] 1 WLR 1037

So the legal and factual context is always highly material to any issue of attribution. It is also material where the issue is one of concurrent liability (which is, I suggest, the most important constituent part of what I am unwilling to call 'veil-piercing'). To explain that a bit more, I suggest that so-called 'veil-piercing' is found, on close inspection, to be an imprecise and misleading label for a variety of legal principles derived from different sources. I repeat what I said in *Prest v Prest*[10] , in which the issue arose in a "big money" divorce :

> "… piercing the corporate veil' is not a doctrine at all, in the sense of a coherent principle or rule of law. It is simply a label – often, as Lord Sumption JSC observes, used indiscriminately – to describe the disparate occasions on which some rule of law produces apparent exceptions to the principle of the separate juristic personality of a body corporate reaffirmed by the House of Lords in *Salomon v A Salomon & Co Ltd* [11]. These may result from a statutory provision, or from joint liability in tort, or from principles of equity and the law of trusts … They may result simply from the potency of an injunction or other court order in binding third parties who are aware of its terms. If there is a small residual category in which the metaphor operates independently no clear example has yet been identified…"

If there is a small residual category of that sort, its existence could be justified as the court's reaction to the abuse of the statutory privilege of incorporation with limited liability. As Lord Sumption pointed out in *Prest v Prest* [12], although English law has no general doctrine of abuse of rights, it does have the principle

> "…that the law defines the incidents of most legal relationships between persons (natural or artificial) on the fundamental assumption that their dealings are honest. The same legal incidents will not necessarily apply if they are not."

Everyone is familiar with the decision of the House of Lords in *Salomon's* case. The speeches of Lord Halsbury LC and Lord Macnaghten, in particular, are very well known. But the case only got to the House of Lords because the first-

[10] [2013] 2 AC 415, 508 (para 106)
[11] [1897] AC 22
[12] [2013] 2 AC 415, 479-480 (paras 17 and 18)

instance judge, and an unanimous Court of Appeal presided over by Lindley LJ, held that what Mr Salomon had done was unlawful. Lindley LJ said,[13]

> "There can be no doubt that in this case an attempt has been made to use the machinery of the Companies Act, 1862, for a purpose for which it was never intended … The object of the whole arrangement is to do the very thing which the legislature intended not to be done…"

Had Mr Salomon not had the determination and the resources for a further appeal to the House of Lords, the course of English company law might have been very different. Not everyone takes the view that it would necessarily have been worse. One very distinguished legal scholar, Otto Kahn-Freund, called the House of Lords' decision "calamitous".[14] A distinguished Australian judge, Windeyer J, spoke in the High Court of Australia [15] of "the unreality and formalism into which the decision in *Salomon's* case has led the law."

The main economic justification for incorporation with limited liability is to enable members of the public to invest some of their savings in commercial ventures which they expect to be profitable, without putting at risk more than the money that they invest (so long as their shares are fully paid up). What Mr Salomon did was not dishonest (as Lord Macnaghten pointed out in his detailed analysis of the facts) but it was certainly some way outside the scope of that economic justification. And things have moved on a long way from there, with companies formed for all sorts of non-commercial purposes, including tax avoidance, risk avoidance, and sometimes criminal activity.

Companies formed for entirely criminal purposes raise issues of particular interest and difficulty, and I will return to them. A more familiar structure (but one which might have surprised Lord Halsbury and Lord Macnaghten) is the modern

[13] *Broderip v Salomon* [1895] 2 Ch 323, 337
[14] Kahn-Freund, Some Reflections on Company Law Reform (1944) 7 MLR 54
[15] *Gorton v Commissioner of Taxation* (1965) 113 CLR 604, 618

group of companies, with a holding company having dozens or even hundreds of subsidiaries, sub-subsidiaries and so on.

During the 1970s epidemiologists and pathologists became increasingly aware that latent diseases caused by exposure to asbestos fibres and mineral dust were a serious threat to human life and health. This led to improved safety measures in mining and heavy industries such as shipbuilding. It also led to the reorganisation of the corporate structure of many groups engaged in those industries, the purpose of the reorganisation being to minimize their legal exposure. That was the background to the *Cape Industries* case[16], decided in 1990. It was an attempt to enforce in England, against an English holding company, a default judgment obtained in a class action in Illinois, and the essential issue was whether the holding company had been present in the United States (or, possibly, in Illinois) when the class action was commenced.

The judgment of Slade LJ is one of the first detailed, in-depth discussions of "veil-piercing". Slade LJ said,[17]

> "…we do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company which is a member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law."

A holding company may be liable, however, if it can be shown that it did in fact assume, and then fail to discharge, duties of care owed directly to persons employed by its subsidiaries.[18]

The underlying aim of minimizing risk by putting only one egg in each basket can also be seen in the "one-ship" company which is so often found in the shipping

[16] *Adams v Cape Industries plc* [1990] Ch 433
[17] at p544
[18] *Connelly v RTZ Corporation plc* [1998] AC 841

world. In the *Atlas Maritime* case [19] Staughton LJ considered a one-ship company that was exposed to exceptional risk. The ship in question, the Coral Rose, had been bought in an unseaworthy condition, had been repaired, and then resold while its seaworthiness was still in doubt. Moreover the purchase and the repairs had all been financed by loans from the holding company, Marc Rich. The Court of Appeal firmly rejected the argument that Marc Rich was acting as agent for its subsidiary. Staughton LJ said,[20]

> "The creation or purchase of a subsidiary with minimal liability, which will operate with the parent's funds and on the parent's directions but not expose the parent to liability, may not seem to some the most honest way of trading. But it is extremely common in the international shipping industry, and perhaps elsewhere. To hold that it creates an agency relationship between the subsidiary and the parent would be revolutionary doctrine."

The Court of Appeal did however uphold a *Mareva* injunction on the ground that the repayment to Marc Rich of part of its loan was not a routine trading transaction. Neill LJ observed,[21]

> "When it comes to considering the exercise of discretion and the scope of injunctive relief it is then legitimate to look at the circumstances and to examine the nature of the debt and the identity of the creditor."

This can be seen as an echo of some general remarks by Lord Wilberforce in the *Westbourne Galleries* case about companies as "quasi-partnerships",[22]

> "The words ["just and equitable"] are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure".

The two best-known cases on concurrent liability in equity are *Gilford Motor*[23] and *Jones v* Lipman[24] . Mr Horne had been the managing director of the Gilford

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[19] *Atlas Maritime Co SA v Avalon Maritime Ltd* [1991]4 All E R 769
[20] at p 779
[21] at p 773
[22] *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, 379

company, and was bound by a covenant (operating for five years in a specified locality) against competition "either solely or jointly with or as agent for any other person, firm or company." He and his wife formed a company which carried on a competing business. The Court of Appeal granted an injunction against both Mr Horne and the company. The injunction against him was unsurprising, in view of the wide terms of the covenant. But the injunction against the company was more debateable.[25]

Jones v Lipman was similar, except that it involved a sale of land. Mr Lipman had contracted to sell his house to Mr and Mrs Jones. Then he had second thoughts, changed his solicitors, and informed the purchasers that he had transferred the house to a third party, whom he initially refused to identify. In due course it emerged that he had sold it at an obvious undervalue to a newly-formed company with two directors and shareholders – Mr Lipman and an employee of his new solicitors. Russell J ordered specific performance against both Mr Lipman and his company, which was, he said,

> "a creature of [Mr Lipman], a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eyes of equity."

The debate about these cases centres on whether the vivid metaphors used by judges (such as "device", "sham" and "mask") are really invoking a special veil-piercing doctrine, or are simply rhetorical embellishments of traditional principles of equity.

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[23] *Gilford Motor Co Ltd v Horne* [1933] Ch 935
[24] [1962] 1 WLR 832
[25] See the differing views of Lord Sumption and Lord Neuberger in *Prest v Prest* [2013] 2 AC 415 at paras 27-29 and 70-72 respectively

Recent authority does not give a clear answer, but on balance tends to suggest that the latter is the better view. In *Yukong Line* [26]

Toulson J quoted from a lecture by Lord Cooke, a distinguished New Zealand judge [27], commenting on *Jones v Lipman:*

> "Those epithets ["a device, sham and mask"], however, do not appear to have been needed to justify the remedy. No particular difficulty should arise in holding that a company or any other purchaser acquiring property with actual notice that the transaction is a fraud on a prior purchaser takes subject to the latter's equity. In truth the very granting of the remedy against the company brings out that it was not a sham."

Toulson J went on to comment that there was no particular reason why the doctrine contended for in the case before him, if it existed, should be confined to companies:

> "If either Mr Horne's wife or Mr Lipman's wife (assuming their existence) had agreed to act in a similar role to that of [the relevant] company, no doubt similar relief would have been granted aagainst the lady concerned."

Many of you will have spotted that there is a conveyancing issue here, which seems to have been overlooked in *Jones v Lipman.*[28] Was the contract with Mr and Mrs Jones protected by registration? If not, Mr Lipman's bad faith would not, it seems, have received the sharp sanction that it deserved. That is the message of the deplorable family feud which went to the House of Lords in *Midland Bank Trust Co Ltd v Green.*[29] The Lords unanimously reversed the decision of the Court of Appeal, presided over by Lord Denning, who had relied on an earlier decision of his won as to the maxim that "fraud unravels everything". I am afraid that Lord Denning is not getting a very good score this evening.

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[26] *Yukong Line Ltd of Korea v Rendsberg Investments Corporation of Liberia* [1988] 1 WLR 294, 307-308

[27] Hamlyn Lecture (1997) on *Salomon's* case

[28] This point was noted by the Court of Appeal in *VTB Capital plc v Nutritek International Corporation* [2012] 2 Lloyd's Rep 313, para 66

[29] [1981] AC 513

Toulson J's observation prompts a further thought. If there is a doctrine of veil-piercing it would consist, I suggested earlier, in the court looking through a company to get at those who control it. In cases like *Jones v Lipman* the court starts with an individual in breach of his obligation, and then looks to see whether the company that he controls is also liable – but it could equally be his wife, or a friend of his. The fact that the transferee is a controlled company is part of the story, but it may not be essential to the legal analysis.

A statute can of course authorise or require some degree of veil-piercing in order to give effect to some parliamentary purpose. The requirements of the Companies Acts in relation to group accounts require the financial statements of subsidiaries to be aggregated with those of the holding company as a single economic unit. European competition law takes a similar approach, unless it is shown (exceptionally) that a subsidiary does not act in accordance with the directions of its holding company.[30] The statutory power to grant relief against oppression of a shareholder has been interpreted so as to enable relief to be granted where a member of a subsidiary is oppressed by the conduct of the holding company.[31]

Statutory interventions of that sort are particularly common in the field of tax. In the early days the formation of a conventional investment-holding company or land-holding company might be sufficient to avoid high rates of personal tax. Now there are numerous provisions about close companies, personal service companies, thinly-capitalised companies, companies engaged in transfer-pricing, and much else. In the days of estate duty, estate companies were sometimes formed with special articles under which the head of the family held shares with rights under which he controlled the company, and was entitled to almost all the dividend income during his

[30] *Commercial Solvents Corporation v European Commission* [1974] ECR 223
[31] *Scottish Co-operative Wholesale Society v Meyer* [1959] AC 324

lifetime, but on his death the shares became almost worthless. This ingenious attempt to replicate a strict settlement in corporate form was countered by legislation which stripped away the corporate ownership by a statutory hypothesis:

> "…[as] if the assets of the company had been held by it on trust for the members thereof and any other person to whom it is under any [non-commercial] liability … and if the company had acted in the capacity of a trustee only with power to carry on the business of the company and to employ the assets of the company therein."

This must be one of the most explicit reversals of *Salomon's* case to be found in any statute. It was effected by section 55 of the Finance Act 1946, long since repealed, and was considered by the House of Lords in *St Aubyn v Attorney General* [32] , the case in which Lord Radcliffe memorably observed the the word "deemed" may be used "to give a comprehensive description which includes what is obvious, what is uncertain and what is, in the ordinary sense, impossible."

Now I want to come back to the topic of breach of duty and illegality, and I shall spend the rest of my time on this topic. The general principle, stated by Lord Mansfield[33] 240 years ago, that

> "No court will lend its aid to a man who founds his cause of action on an immoral or illegal act"

has given rise to many difficulties and shifts of judicial opinion. These have recently been considered by the Supreme Court in *Jetivia*[34]. So far as the discussion addressed the broad general principle underlying the illegality defence, the judgments are inconclusive. But in upholding the admirable decision of the Court of Appeal[35] they have gone a long way to clarify the particular difficulties at the interface of illegality and corporate attribution.

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[32] [1952] AC 22, 53

[33] *Holman v Johnson* (1775) 1 Cowp. 341, 343

[34] *Jetivia SA v Bilta (UK) Ltd* [2015] UKSC 23; see especially Lord Neuberger at paras 12-17 (explaining why this was not the occasion to revisit *Tinsley v Milligan* [1994] 1 AC 340), Lord Sumption at paras 60-64, and the joint judgment of Lord Toulson and Lord Hodge at paras 168-174

[35] [2014] Ch 52

Consider four different situations involving serious breaches of duty. First, a company may be formed by promoters who intend, from the outset, to cheat those who are persuaded to invest in it. Second, an established company may fall into the hands of unscrupulous directors who plan to siphon off its assets for their own benefit, defrauding the shareholders. Third, a company may be formed by one or more individuals who intend, from the outset, to use it for the purpose of defrauding outsiders – that is, persons who are not shareholders, but may become trade creditors of the company. Fourth, a company, although not formed for the sole purpose of fraud, may at some stage embark on defrauding its customers or its creditors.

A good example of the first category – company promoters cheating their investors – is the decision of the House of Lords in *Gluckstein v Barnes* [36] in 1900. Some businessmen had acquired the Olympia exhibition premises in London. They formed a company to purchase and manage the premises, concealing the fact that they were making a secret profit of £20,000. The company soon failed and the liquidator brought a claim against Mr Gluckstein. He argued that the promoters' knowledge of the secret profit amounted to the company's knowledge, and so the company must be taken to have approved it. The Earl of Halsbury LC dismissed this argument with characteristic force:

> "My Lords, I decline to discuss the question of disclosure to the company. It is too absurd to suggest that a disclosure to the parties to this transaction is a disclosure to the company of which these directors were the proper guardians and trustees".

Lord Macnaghten was equally dismissive, calling the argument "absurd" and "mere farce".

[36] [1900] AC 240, 247, 249

The principle which the House of Lords regarded as so clear as to need no discussion is sometimes called "the rule in *Hampshire Land"* [37] , but in fact there was no more than a dictum in *Hampshire Land* , picked up a generation later by Viscount Dunedin and Viscount Sumner in *Houghton*.[38] It can also be referred to as the "breach of duty exception"[39], but the better view among legal scholars is that it is not a true exception so much as an illustration that any issue of attribution is always highly contextual, and the context includes the type of claim in which the issue of attribution arises. Please note that despite the strong language used in the House of Lords, illegality as such was not an issue in *Gluckstein v Barnes.* The case turned simply on attribution.

The best example of my second category is the pair of *Belmont* cases[40], which were referred to in *Jetivia* [41] as the starting point for the modern law. By a complicated series of transactions two groups of businessmen extracted assets worth about £500,000 from Belmont. In the first appeal (decided on assumed facts) Buckley LJ stated and applied the breach of duty exception in terms that did refer to illegality:

> "But in my view such knowledge [the directors' knowledge of illegality] should not be imputed to the company, for the essence of the arrangement was to deprive the company improperly of a large part of its assets. As I have said, the company was the victim of a conspiracy. I think it would be irrational to treat the directors, who were allegedly parties to the conspiracy, notionally as having transmitted this knowledge to the company…"

Buckley LJ went on to refer to the general law of agency.

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[37] *Re Hampshire Land Company* [1896] 2 Ch 743
[38] *Houghton and Co v Nothard,Lowe and Wills Ltd* [1928] AC 1, 14, 19
[39] Lord Sumption in *Jetivia*, fn 34 above, at para 71
[40] *Belmont Finance Corporation Limited v Williams Furniture Ltd* [1979] Ch 250; *same (No 2)*[1980] 1 All E R 393
[41] fn 34 above, para 74 (Lord Sumption)

In *Jetivia*[42] Lord Sumption made some observations about this which command close attention, although they may be regarded as controversial until *Tinsley v Milligan* [43] is eventually revisited:

> "The fundamental point made by the Court of Appeal in this case and the Court of Final Appeal in *Moulin* is that, while the basic rules of attribution may apply regardless of the nature of the claim or the parties involved, the breach of duty exception does not. I agree with this. It reflects the fact that the rules of attribution are derived from the law of agency, whereas the fraud exception, like the illegality defence which it qualifies, is a rule of public policy."

The third category is a company formed solely for criminal purposes. The well-known authorities include three such companies: Scanlynn Limited,[44] Stone & Rolls Limited[45] and Bilta (UK) Limited[46]. Scanlynn had a real business. It was engaged in smelting, recasting and selling gold bullion stolen in the notorious Brinks-Mat robbery; some of the recast gold is said to have been sold to Johnson Matthey, from whom it had been stolen. Stone & Rolls pretended to have a business as wholesale international grain-merchants, and perpetrated a long-firm fraud which cost some European banks a total sum of the order of US$ 100 million. Bilta was a company formed in order that it should, in a conspiracy with an overseas company called Jetivia, defraud HM Revenue and Customs, by dishonest transactions in European emissions trading scheme credits, of VAT of the order of £38 million.

The feature that all these diverse forms of criminal activity had in common was that at the end of the day the company in question was insolvent. The individual conspirators had made off with the proceeds of their crimes, and a liquidator or receiver was trying to recover the assets (or compensation) for the benefit of the true

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[42] fn 34 above, para 86
[42] [1994] 1 AC 340
[44] *Brinks-Mat v Noye* [1991] 1 Bank LR 68
[45] *Stone & Rolls Ltd v Moore Stephens* [2009] 1 AC 1391
[46] fn 34 above

victims of the crimes: Brinks-Mat (the bailee) and Johnson Matthey (the owner) in the first case, the European banks in the second, and HMRC in the third. But in order to obtain redress for the true victims the claimant had to portray the insolvent company as a victim also. In *Brinks-Mat* that expression was used by Nicholls LJ and Mustill LJ in the Court of Appeal to describe Scanlynn Limited. Later cases[47] began to develop the difficult concept of "primary" and "secondary" victims.

In *Stone & Rolls* [48] Lord Phillips said that his first reaction was that that company, could not be seen as a victim (and he might equally have said it about Scadlynn or Bilta):

> "They [Stone & Rolls] started with nothing and their alleged losses are sums that they acquired by fraud and then paid away as art of the same fraudulent transaction. If a person starts with nothing and never legitimately acquires anything he cannot realistically be said to have suffered any loss."

I have to say that I was instinctively inclined to agree with that view. But I must have been falling into the metaphysical and anthropomorphic fallacy of seeing the company as having been conceived and born in an irremediable state of original sin. In *Jetivia* [49] the Supreme Court approved the reasoning in *Brinks-Mat.* Lord Toulson and Lord Hodge referred to the general principle established by *Bowman v Secular Society Ltd* [50] that the illegality of a company's purposes does not invalidate its incorporation. But Lord Sumption pointed out, reassuringly, that the clarification of the law achieved by *Jetivia* "makes it unnecessary to address the elusive distinction between primary and secondary victimhood".

Stone & Rolls was a three-two decision in which I was one of the majority. It is a case which has attracted a great deal of adverse comment from legal scholars.

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[47] Starting, it seems, with *Arab Bank plc v Zurich Insurance Co* [1999]1 Lloyd's LR 262
[48] fn 45 above, para 5
[49] fn 34 above, paras 163- 165 and 177 (Lord Toulson and Lord Hodge); para 93 (Lord Sumption)
[50] [1917] AC 406

The criticism was justified because (as the Law Commission[51] put it in moderate language)

> "It is difficult to anticipate what precedent, if any, *Stone & Rolls* will set regarding the illegality defence. Though there was a majority verdict, there was no majority reasoning, with all their Lordships reaching different conclusions on how the defence should be applied."

I must respectfully agree with Lord Neuberger's giving the case its *quietus* in *Jetivia*[52]

> "…the time has come in my view for us to hold that the decision in *Stone & Rolls* should, as Lord Denning MR graphically put it… be put on one side and marked not to be looked at again."

Jetivia was a claim made by the liquidators of Bilta, a British company, against its two directors, Mr Chopra and Mr Nazir, and also against Jetivia, a Swiss company, and its chief executive, Mr Braunschweiler. Bilta had purchased emissions credits from European companies, free of VAT because it was a cross-border transaction. It then resold the credits to British companies, charging VAT, at a rather lower price net of VAT (in order to dispose of them quickly). Bilta was accountable to HMRC for the tax, and it was therefore in an insolvent position as a result of selling the credits at a small loss. But HMRC never got the tax; the money was misappropriated by transfer to Jetivia under a large-scale conspiracy between Mr Chopra, Mr Nazir and Mr Braunschweiler. Unless the misappropriated funds were recovered Bilta would be not merely slightly insolvent, but massively insolvent, with no assets at all and HMRC as a creditor for about £38 million. In that sense Bilta, although formed for criminal purposes, was a victim. HMRC might be seen as the real victim but in the proceedings its recovery of the VAT depended on the success of the

[51] The Illegality Defence (2010) Law Com 320, para 3(32)
[52] fn 34 above, para 30

liquidators' claim (though recent authority[53] suggests that HMRC might have proceeded directly against the conspirators in tort).

The conspirators relied on the defence of illegality. This was successively rejected by Sir Andrew Morritt C, the Court of Appeal (Lord Dyson MR, Rimer LJ and Patten LJ) and the Supreme Court (both higher courts being unanimous, though with some differing reasons in the Supreme Court). Each member of the Court of Appeal had already, at some stage in his judicial career, grappled with these problems.[54] The judgment of Patten LJ is, if I may respectfully say so, one of those special judgments, like that of Lord Hoffmann in *Meridian* [55], in which a judge clarifies – simplifying as much as possible, but not more than that, as Albert Einstein is reputed to have said – a really difficult area of the law. It was the problem which *Stone & Rolls* had regrettably failed to clarify. The whole of Patten LJ's judgment deserves careful study. I will quote two short passages from the two crucial paragraphs, which were quoted at length by Lord Sumption in the Supreme Court:[56]

> "…attribution of the conduct of an agent so as to create a personal liability on the part of the company depends very much on the context in which the issue arises. In what I propose to refer to as the liability cases like *El Ajou, Tan, McNicholas* and *Morris,* reliance on the consequences to the company of attributing to it the conduct of its managers or directors is not enough to prevent attribution because, as Mummery LJ pointed out, it would prevent liability ever being imposed. As between the company and the defrauded third party, the former is not to be treated as a victim of the wrongdoing on which the third party sues but one of the perpetrators …
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> But, in a different context, the position of the company as victim ought to be paramount. Although the loss caused to the company by its director's conduct will be no answer to the claim against the company by the injured third party, it will and ought to have very different consequences when the company seeks to recover from the director the loss which it has suffered through his actions. In such cases the company will itself be seeking compensation by an

[53] *Revenue and Customs Commissioners v Total Network SL* [2008] 1 AC 1174

[54] Dyson J in *McNicholas Construction Co Ltd v Customs & Excise Commissioners* [2000] STC 553; Rimer LJ in *Stone & Rolls,* fn 45 above; Patten J in *Morris v Bank of India* [2005] 2 BCLC 328

[55] fn 6 above

[56] fn 35 above, paras 34 and 35 (Patten LJ); fn 34 above, para 84 (Lord Sumption)

> award of damages or equitable compensation for a breach of the fiduciary duty which the director or agent owes to the company. As between it and the director, it is the victim of a legal wrong."

You will observe that these passages do not cover proceedings in which a company is seeking compensation from a third party (typically its auditors or insurers) for a loss which the company has suffered as a result of breaches of duty by its own directors or employees. *Stone & Rolls* was such a case. It was a claim brought by a company in liquidation against its auditors. So was the *Arab Bank* case.[57] It was a claim against insurers who had issued a professional indemnity policy to an incorporated firm of estate agents. For both auditors and professional indemnity or fidelity insurers breach of duty by directors or employees is arguably the "very thing" that they have undertaken responsibility for. These cases may turn on particular contractual terms, but before *Jetivia* the general tendency in cases of this type had been to apply the breach of duty exception.

In *Jetivia* the Supreme Court did address what Lord Sumption called "the third situation".[58] The relevant passages call for careful study, but their general effect, as I understand it, is that claims for compensation of this type should not be analysed in terms of a supposed " breach of duty exception", but considered more generally, bearing in mind "the need for attention to the context and purpose for which attribution is invoked or disclaimed" (Lord Mance) and that "the attribution of legal responsibility for the act of an agent depends on the purpose for which attribution is relevant" (Lord Sumption, citing Lord Hoffmann).

The last case I want to mention is an example of a successful company whose business turned down, and whose controlling directors embarked on dishonesty in

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[57] *Arab Bank plc v Zurich Insurance Co* [1999] 1 Lloyd's LR 262

[58] fn 34 above, paras 9 (Lord Neuberger), 37-44 (Lord Mance), 87 and 91-93 (Lord Sumption) and 204 and 207-209 (Lord Toulson and Lord Hodge)

order to deceive their bankers and other creditors. It is also an example, and an unusual example, of a company trying to recover from a third party a loss caused by its own directors' fraud. It is the *Moulin Global Eyecare Trading* case[59], decided by the Court of Final Appeal of Hong Kong, which I have already mentioned in passing.

Business life in Hong Kong is full of surprises, but the sudden appointment of provisional liquidators of Moulin Trading was particularly surprising. It was the principal trading subsidiary of a company quoted on the Hong Kong stock exchange. It appeared to be one of the world's biggest players in the manufacture, distribution and retail sale of spectacles, regularly reporting healthy profits. But after lengthy investigations the liquidators reported that the group's accounts had been falsified for at least six years, despite having been audited successively by two of the big four firms of accountants. The falsification was carried out by three executive directors based in Hong Kong (other directors ran factories in mainland China and wre not involved in the fraud). The motive of the executive directors was, apparently, to persuade banks to keep extending credit to the group.

The collapse of Moulin Trading and the rest of the group led to various sets of legal proceedings. The three executive directors in Hong Kong were arrested, convicted and sentenced to long terms of imprisonment. There were also civil claims against them. There were civil claims, which were settled, against the two sets of auditors. There was also, and most materially for present purposes, a public law claim by the liquidators against the Commissioner of Inland Revenue seeking to recover about HK$ 90 million which Moulin Trading paid, over six years, in profits tax on non-existent profits.

[59] fn 8 above

The case illustrates yet again the importance of context in questions of attribution. The context was the Hong Kong legislation on the management of profits tax, which is quite similar to that in force in the United Kingdom. The essential issues were whether Moulin Trading had been "prevented" from objecting to assessments (within the meaning of section 64 of the Inland Revenue Ordinance) and whether it had made an "error" in its returns (within the meaning of section 70A). Hong Kong case law established that a deliberate lie is not an error.[60] The attribution to Moulin Trading of the guilty states of mind of the executive directors was therefore an issue.

I wrote the leading judgment in the Court of Final Appeal. Counsel for the liquidators of Moulin Trading submitted that "the real company" had been "hijacked" by the rogue directors. In rejecting that submission I observed,[61]

> "the difficulty is that this approach involves not merely metaphor ("hijacking") but also metaphysics ("the real [Moulin Trading]"). As Lord Hoffmann put it in *Meridian,* displaying his knowledge of the German philosopher Immanuel Kant, "There is in fact no such thing as the company as such, no *ding an sich,* only the applicable rules."

The decision of the Court of Final Appeal, dismissing the liquidators' appeal, has now been approved by the Supreme Court in *Jetivia.* Although further aspects of illegality remain to be explored, *Jetivia* is the most important case since *Meridian,* twenty years ago, in clarifying the content of what Lord Hoffmann referred to, in prosaic and non-metaphysical language, as the applicable rules.

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[60] *Extramoney Ltd v Commissioner of Inland Revenue* [1997] HKLRD 387

[61] fn 8, para 125; see also Lord Mance in *Jetivia,* fn 34 above, para 39