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Company directors – when will companies be responsible for the things they do?

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Introduction

1. It is an axiom of corporate law in the common law world that companies have a separate legal personality. A problem flows immediately from this principle:

> "*a corporation is an abstraction. It has no mind of its own any more than a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.*"[1]

2. How then to determine what acts performed by a company's human agents are to be regarded as acts carried out by the company?

3. The law of attribution steps in to answer this question: it is all about ascribing acts, knowledge and intention to companies. In Meridian Global Funds Management Asia Limited v Securities Commission [1995] 2 AC 500, Lord Hoffmann said:

> "*A company exists because there is a rule (usually in a statute) which says that a persona ficta shall be deemed to exist and to have certain of the powers, rights and duties of a natural person. But there would be little sense in deeming such a persona ficta to exist unless there were also rules to tell one what acts were to count as acts of the company. It is therefore a necessary part of corporate personality that there should be rules by which acts are attributed to the company. These may be called "the rules of attribution.*"[2]

4. Lord Hoffmann referred to three sources of these "*rules of attribution*":[3]

   (1) the primary rules of attribution deriving from the company's constitution;

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[1] Lennard's Carrying Company v Asiatic Petroleum Ltd [1915] AC 705, 718.

[2] Meridian, 506.

[3] Meridian, 506-507.

(2) the general rules of attribution being the general rules of agency; and

(3) special rules of attribution based on the case-by-case requirements of substantive rules of law.

5. The value of understanding the rules of attribution for lawyers is that it enables us to advise businesses on how to ensure that the steps of corporate entities will be binding, or how the steps taken on their behalf will bind them. Otherwise, how could anyone have any certainty about the enforceability transactions they enter with corporations?

6. Perhaps more significantly still, attribution is one of the key principles for holding companies, who usually are the parties with the assets (or the insurance), responsible for defaults or misdeeds supposedly carried out in their name. In this context the answer as to whether a company is responsible for such a default may be different depending on whether the purpose is to apportion responsibility as between the company and its agents, or as between the company and a third party. It may also be important to distinguish between vicarious liability and liability arising from attribution which will be direct.

The primary rules of attribution – the relationship between directors and the company

7. The constitutional position of a company's directors will depend on the provisions in the company's articles. In general, a company acts primarily through its board of directors, and it follows that their acts and state of mind are attributable to the company is its primary directing organ under the constitution.[4]

8. The general position under Art 64 of the Companies (Standard Table) (Jersey) Order 1992 is that "*Subject to the provisions of the Law, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company.*"[5]

9. Therefore, directors usually have a large degree of control over the affairs and business of the company, with shareholders only being able to give directions to them by a special resolution. The supremacy of the board over the members, at least in the course of the day-

[4] Bilta (UK) Ltd v Nazir [2016] AC 1, at [67].

[5] Article of the 3 of the English Companies (Model Articles) Regulations 2008/3229 provide that "*Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.*" Article 4(1) contains a reserve power for the shareholders: "*The shareholders may, by special resolution, direct the directors to take, or refrain from taking, specified action.*"

to-day management of a company, was underscored in Barron v Potter [1914] 1 Ch 895, where Warrington J said:

> "*in ordinary cases where there is a board ready and willing to act it would* [not] *be competent for the company to override the power conferred on the directors by the articles except by way of special resolution for the purpose of altering the articles.*"[6]

10. As the Jersey Standard Table makes clear, the power of management is vested in the board of directors: collective management is required, although directors may delegate their powers, whether to a committee or to a single director.[7] However, in the absence of such delegation, a director acting alone does not have power to bind the company, nor does a majority of directors acting outside of a properly constituted meeting.[8]

11. Directors may still bind the company, even where their appointment is flawed: s. 80 of the Companies (Jersey) Law 1991 provides that "*the acts of a director are valid notwithstanding any defect that may afterwards be found in the director's appointment or qualification.*"[9] The section is intended to protect shareholders and outsiders who deal with the company in good faith, so that the company cannot escape the consequences of a transaction.[10]

12. In addition, a validly constituted board meeting has the power to ratify the acts of an irregularly constituted board meeting, thereby making it valid *ab initio*.[11]

13. Further, where there are irregularities or ambiguities relating to the acts of directors under the company's constitution, the company will still be bound when dealing with third parties acting in good faith, pursuant to the rule in Royal British Bank v Turquand (1856) 6 E&B 327. In that case, it was held that, provided the agent would otherwise have usual or ostensible authority to enter into the transaction in question, the third party's claim to uphold the transaction would not be defeated solely on the basis of ambiguities in the

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[6] Barron v Potter [1914] 1 Ch 895, 902.

[7] For the power to delegate, see art. 66 of the Jersey Standard Table.

[8] Re Portuguese Consolidated Copper Mines Limited (1889) 42 Ch D 160; Re Bank of Syria [1901] 1 Ch 115.

[9] The English equivalent of this provision has been interpreted as requiring a purported appointment that suffers from a procedural defect, or where a director has vacated office but continues to act, rather than a situation where there has been no appointment at all: Morris v Kanssen [1946] A.C. 459, 471.

[10] Channel Collieries Trust, Limited v Dover, St. Margaret's and Martin Mill Light Railway Company [1914] 2 Ch 506.

[11] See e.g. Re Portuguese Consolidated Copper Mines Ltd (1890) 45 Ch D 16 at 26-27.

company's constitutional documents. In Kreditbank Kassel GmbH v Schenkers Ltd [1927] 1 KB 826, at 844, Atkin LJ expanded on this principle:

> "*If you are dealing with a director in a matter in which normally a director would have power to act for the company you are not obliged to inquire whether or not the formalities required by the articles have been complied with before he exercises that power*."

The general rules of attribution - authority & agency

14. Companies act, of course, by individuals other than directors, whether employees or third-party agents. In Meridian, at 505, Lord Hoffmann observed that a company:

> "*will appoint servants and agents whose acts, by a combination of the general principles of agency and the company's primary rules of attribution, count as the acts of the company. And having done so, it will also make itself subject to the general rules by which liability for the acts of others can be attributed to natural persons, such as estoppel or ostensible authority in contract and vicarious liability in tort.*"

15. Section 20 of the Companies Act provides that:

> "*a person acting under the express or implied authority of a company may make, vary or discharge a contract or sign an instrument on behalf of the company in the same manner as if the contract were made, varied or discharged or the instrument signed by a natural person.*"

16. As the company may be bound by people who have actual or implied authority to enter into transactions, the liability of a company when dealing with third parties is, to a significant degree, subject to the application of the rules of agency.

17. While directors only have power to act within the scope of their authority (which is determined by the articles), since they have the power to manage the company's day-to-day business, third parties dealing with the directors are unlikely to run into the difficulty that acts by the directors exceed their actual authority.

18. Turning to other agents, whether they be employees or others in a position of agency, a third party will be able to rely on actual authority; or on ostensible authority if he can establish the following four points:[12]

[12] Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd [1964] 2 QB 480, 506.

(1) that a representation was made to the third party that the agent had authority to enter on behalf of the company into a contract of the kind sought to be enforced;

(2) that such representation was made by a person or persons who themselves had actual authority to manage the business of the company either generally or in respect of those matters to which the contract relates;

(3) that the third party was induced by that representation to enter into the contract (i.e. the third party relied upon it); and

(4) that under its memorandum or articles of association the company was not deprived of the capacity either to enter into a contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent (although this last condition applies only where the third party knows of or is put on inquiry as to the limitations in the company's constitution).

19. Thus the general rules of agency will determine whether an act is that of the company.

20. It should be noted at this stage that because a company can be made vicariously liable for the torts of its agents and employees, it may not be necessary to determine whether or not attribution should take place for a company to be liable. Vicarious liability is much less sensitive to the kinds of questions that arise in relation to attribution and, as such, is capable of applying relatively frequently; as Lord Sumption observed in Bilta:

> "*vicarious liability does not involve any attribution of wrongdoing to the principal. It is merely a rule of law under which a principal may be held strictly liable for the wrongdoing of someone else*."[13]

21. However, even within vicarious liability there are a number of anomalies and overlaps in terminology with agency and attribution:

(1) In general terms a principal (including an employer) will be liable for the actions of its agent (or employee) if they are sufficiently closely connected with the activities carried on by the principal (or with the employment): Cox v Ministry of Justice

[13] Bilta v Nazir, [70]. The *quid pro quo* for this relatively unfettered application is that the range of claims for which it can render a company liable is more restricted than the principles of attribution: see Bilta, [186], where Lords Hodge and Toulson explained that "*vicarious liability is indirect liability; it does not involve the attribution of the employee's act to the company. It entails holding that the employee has committed a breach of a tortious duty owed by himself, and that the company as his employer is additionally answerable for the employee's tortious act or omission*."

[2016[AC 660 and Mohamud v William Morrison Supermarkets [2016] AC 677. Thus, unlike attribution, the issue is not one of agency (actual or ostensible) but a broader test.

(2) This broader test was developed in the context of torts involving personal injury caused by the actions of the agent/employee which would not have been authorised (for example, in Mohamud the employee, a petrol station worker, punched a customer on the forecourt and the employer was held to be liable for that action). It has however, been applied to negligent misstatement: see, for example, HSBC v 5th Avenue Partners Ltd [2009] EWCA Civ 296.[14]

(3) By contrast, where the wrongdoing alleged is in deceit, then the principal/employer will only be liable if the agent/employee's deceit is within the terms of its actual or apparent authority: Armagas Ltd v Mundogas SA [1986] AC 717 and followed, recently, in Winter v Hockley Mint Ltd [2018] EWCA Civ 2480. Thus, the liability of the company will depend on agency principles even for vicarious, as opposed to direct, liability.

The special rules of attribution

22. The third of Lord Hoffmann's categories – the special rules of attribution – deals largely with cases where the state of mind of a corporation is in issue and where neither strict liability nor vicarious liability is applicable.

23. It is illustrated by the decision of the House of Lords in Lennard's Carrying Company v Asiatic Petroleum Ltd [1915] AC 705. The House of Lords had to consider a defence under s. 502 of the Merchant Shipping Act 1894, which provided a shipowner with a defence if he could show that the loss happened "*without his actual fault or privity*". In this case, the ship was owned by a company, but the wording of s 502 excluded the corporation being able to rely on the absence of fault of an agent. Rather the statutory provision required there to be no fault or privity on the part of:

[14] Aspects of this decision do not sit easily with the conclusion of the House of Lords in Williams v Natural Life Health Foods Ltd [1998] 1 WLR 830 that a director *or employee* will only be personally liable for a misstatement made in the course of carrying out their functions for the company if there was a special relationship between them and the claimant. In order words the director or employee must have assumed responsibility for the statement. Where the statement is fraudulent, the maker of the statement will be personally liable: Standard Chartered Bank v Pakistan National Shipping Corporation (No.2) [2003] 1 AC 959.

> "*somebody who is not merely a servant or agent for whom the company is liable upon the footing respondeat superior, but somebody for whom the company is liable because his action is the very action of the company itself*."

24. In the case, there was a single managing director who was found to be the "*directing mind and will*" of the company; accordingly, his knowledge of the unseaworthiness of the relevant ship was attributed to the company, rendering the statutory defence unavailable.

25. Eighty years later, in Meridian, Lord Hoffmann referred to situations where neither the primary rules of attribution or principles of agency applied, in which case the court "*must fashion a special rule of attribution for the particular substantive rule*". This may particularly be the case in a statutory context.[15]

26. Fashioning the special rule of attribution involves an examination of the relevant provision of law that has allegedly been breached. The court's task is to determine, in that context, whose knowledge or state of mind counts as the company's knowledge or state of mind. As Meridian demonstrates, authority to carry out particular acts or functions on behalf of the company is likely to be a strong indicator of whose acts, knowledge or state of mind are to be attributed to the company. However, answering that question requires close analysis of the relevant legal provision and the policy behind it: in what circumstances does that provision apply, and what result is it seeking to achieve, or what is it trying to prohibit?

27. This process is context-specific and, accordingly, what counts as the company's knowledge in one situation will not count as the company's knowledge in all circumstances. As Lord Hoffmann observed:

> "*in a case in which a company was required to make a return for revenue purposes and the statute made it an offence to make a false return with intent to deceive, the Divisional Court held that the mens rea of the servant authorised to discharge the duty to make the return should be attributed to the company* […] *On the other hand, the fact that a company's employee is authorised to drive a lorry does not in itself lead to the conclusion that if he kills someone by reckless driving, the company will be guilty of manslaughter*."[16]

28. This was elaborated on in Bilta v Nazir; after a comprehensive review of the authorities, the Supreme Court concluded that the cases demonstrate that:

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[15] Bilta v Nazir, [40].

[16] Meridian, 511-12.

> "*a finding that a person is for a specific purpose the "directing mind and will" of a company, when it is not merely descriptive, is the product of a process of attribution in which the court seeks to identify the purpose of the statutory or common law rule or contractual provision which might require such attribution in order to give effect to that purpose*"[17] (emphasis added).

Attribution: a lack of coherence?

29. The nature of attribution creates apparent contradictions in the purposes for which the acts of the company's agents will be attributed to the company. The paradigm example is where the directors cause loss to a company by entering into a fraudulent transaction with a third party on its behalf, so as to give that third party a cause of action against the company. As Lord Mance pointed out in Bilta, as a matter of policy:

> "*if the officer's breach of duty has led to the company incurring loss in the form of payments to or a liability towards third parties, the company must be able as part of its cause of action against its officers to rely on the fact that, in that respect, its officers' acts and state of mind were and are attributable to the company, causing it to make such payments or incur such liability. In other words, it can rely on attribution for one purpose, but disclaim attribution for another*"[18] (emphasis added).

30. How far this goes will depend on the nature of the company in question, the participation of its board and / or shareholders in the wrongful acts of its directors and the economic interests at stake in the question of attribution. For instance, Bilta was a "*one-man*" company in the sense that it had only two directors, both of whom were involved in the frauds it perpetrated, and one of them was the sole shareholder. However, because the company was insolvent, the interests of creditors were at play: recovery in that case was for their benefit.[19] This militated against attribution of the frauds carried out by the directors to the company in the context of a claim brought by the liquidator against the directors.

31. As Lords Toulson and Hodge pointed out, there will be three main contexts where questions of attribution arise:

> "*(i) when a third party is pursuing a claim against the company arising from the misconduct of a director, employee or agent, (ii) when the company is pursuing a claim against a director or an employee for breach of duty or breach of contract, and (iii) when the company is*

[17] Bilta v Nazir, [9], [37]-[43], [202].

[18] Bilta v Nazir, [43].

[19] Bilta v Nazir, [7], [32], [38], [42], [123]-[127], [167] and [170].

pursuing a claim against a third party."[20]

32. In each category, depending on the particular factual background and the nature of the legal rules that are being invoked, there may be differing outcomes as a result of the special rules of attribution. Although this flexible approach creates a certain degree of unpredictability about what a court will do, it provides for a pragmatic approach.

33. In addition, a principle known as the fraud or breach of duty exception emerged early on in Re Hampshire Land Company (No 2) [1896] 2 Ch 743.[21] In Stone & Rolls [2009] 1 AC 1391, the court said that the effect of this principle was that:

> "*knowledge of the agent will not be attributed to the principal when the knowledge relates to the agent's own breach of duty to his principal. The rationale for Hampshire Land has been said to be that it is contrary to common sense and justice to attribute to a principal knowledge of something that his agent would be anxious to conceal from him.*"[22]

34. It is more appropriate to see this not as a free-standing exception, but as an illustration of how attribution is context-specific, fact-driven and responsive to policy questions: the Supreme Court recently observed that this so-called principle is really just a reflection of the importance of context when deciding questions of attribution.[23]

Attribution: a one-man show?

35. A further issue that has bedevilled this area is the emphasis in Stone & Rolls on the concept of a "*one-man company*", which has been identified as an essential ingredient in the reasoning of the majority (which is nevertheless a case in which the *ratio decidendi* is elusive).[24] In Stone & Rolls, the frauds carried out by the company's sole shareholder and director were attributed to the company when its liquidator sought to bring a claim against

[20] Bilta v Nazir, [204].

[21] In that case, company directors exercised their authority to borrow money on its behalf on the basis of a resolution made at a meeting. That meeting was convened on the basis of a defective notice. The loan was made by another company. Both companies had the same secretary. The court refused to attribute the secretary's knowledge of the defects in the notice of the relevant meeting, and thus the lack of proper authority for the contract, to the lender-company, which had proved in the borrower-company's liquidation for the loan.

[22] Stone & Rolls, [43].

[23] Bilta v Nazir, *per* Lord Neuberger at [9], Lord Mance [43]-[44], Lords Toulson and Hodge at [181].

[24] See Stone v Rolls, at e.g. [18], [174], [203]. For a full discussion of this aspect of attribution and the other related issues, see Prof. S. Worthington, Corporate attribution and agency: back to basics, L.Q.R. 2017, 133 (Jan), 118-143.

its auditors. The auditors were therefore able to strike out the claim on the grounds of illegality.

36. However, in emphasising this concept, the courts have run the risk of collapsing the distinction between the company's legal personality and the separate legal personalities of its human agents.

37. In recent cases, the concept of a "*one-man company*" has been considered and clarified (to an extent) before being, largely, rejected by the Supreme Court as a touchstone of attribution.

38. Starting with Bilta v Nazir, Lords Neuberger, Neuberger, Clarke and Carnwath defined such a company as one "*in which, whether there was one or more than one controller, there were no innocent directors or shareholders.*"[25] Lords Toulson and Hodge, on the other hand, described such a company as "*a company which has no individual concerned in its management and ownership other than those who are, or must (because of their reckless indifference) be taken to be, aware of the fraud or breach of duty with which the court is concerned*".[26]

39. In Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd [2018] 1 WLR 2777, the Court of Appeal held that the proper definition of a "*one-man company*" was the one adopted by the majority in Bilta v Nazir.[27]

40. The decision on the facts in Singularis also demonstrates that, in the case of a company with more than one director, attribution of a particular director's misconduct or dishonest state of mind may be difficult even where that director is the controller of the company. The first instance judge, Rose J, held that, while one director (Mr Al-Sanea) had misappropriated funds from the company, his acts could not be attributed to the company. This was because the Judge could not make findings that the other members of the board were complicit in the misappropriation of the moneys.[28] As the other directors were not

[25] Bilta v Nazir, [26] and [80].

[26] Bilta v Nazir, [146]. This adopted Lord Walker's formulation in Stone & Rolls.

[27] Singularis, [53].

[28] See the first instance judgment at [2017] Bus LR 1386, [189].

complicit, Singularis was not a "*one-man company*" and Mr Al-Sanea's wrongdoing could not be attributed to the company so as to give Daiwa an illegality defence.[29]

41. The existence of an innocent board with one single bad apple was not the only factor for the Court of Appeal declining to attribute Mr Al-Sanea's wrongdoing to the company:[30]

    (1) Unlike Stone & Rolls, Singularis had not been created merely to facilitate frauds. It was established to carry out legitimate transactions as an asset-management company.

    (2) That legitimate business had been carried out over a number of years, whereas Mr Al-Sanea's misappropriation of company funds had started relatively shortly before the company became insolvent.

    (3) The claim was concerned with the Defendant's breach of its Quincecare duty not to execute orders from a client when 'on inquiry' that the order is an attempt to misappropriate funds.[31] Attributing Mr Al-Sanea's actions to the company in its claim against Daiwa, which owed the Quincecare duty, in order to give Daiwa an illegality defence, would denude that duty of any value.

42. Similarly, in Julien v Evolving Tecknologies and Enterprise Development Co Ltd [2018] BCC 376, in *obiter* remarks, the Privy Council refused to accept the argument that, as a general principle of attribution, the knowledge of a sole shareholder (whose decisions in that capacity in relation to a solvent company are treated as decisions of that company) should be attributed to the company for the purposes of a defendant's limitation defence. The Privy Council noted that the principle that unanimous shareholder decisions are treated as decisions of the company applies equally to unanimous decisions where there is a multitude of shareholders, and it was difficult to see why this would give rise to the attribution of relevant knowledge in a limitation context.[32]

43. However, the Court of Appeal in Singularis also criticised the concept of a "*one-man company*" and underscored that:

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[29] Singularis, [53]-[54].

[30] Singularis, [56]-[59].

[31] See Barclays Bank plc v Quincecare Ltd [1992] 4 All ER 363.

[32] Julien v Evolving Tecknologies and Enterprise Development Co Ltd [2018] BCC 376, [43]-[62].

> "*the circumstances in which such attribution will be appropriate will be fact sensitive, as has been repeatedly said, but I do not think the evaluation of the facts is much assisted by trying first to decide whether the company in question fts within the parameters of various competing definitions of the term 'one-man company'* […] *there can be no situation in which an attribution can be made without a detailed consideration of the factual context, the nature of the claim being made, and the purpose for which the attribution is sought.*"[33]

44. The Supreme Court in Singularis [2019] UKSC 50, a judgment given only last week, has sought to move the debate further away from whether or not the relevant company was a "*one-man company*" or not; and to put an end to the debate based on Stone & Rolls. Lady Hale said at [34]:

> "*….But in any event, in my view, the judge was correct also to say that "there is no principle of law that in any proceedings where the company is suing a third party for breach of a duty owed to it by that third party, the fraudulent conduct of a director is to be attributed to the company if it is a one-man company". In her view, what emerged from Bilta was that "the answer to any question whether to attribute the knowledge of the fraudulent director to the company is always to be found in consideration of the context and the purpose for which the attribution is relevant" (para 182). I agree and, if that is the guiding principle, then Stone & Rolls can finally be laid to rest.*"

Conclusion

45. Attribution is a fundamental part of corporate law – it is the body of rules by which the law determines what are the acts and knowledge of a company.

46. Although attribution depends primarily on a company's constitution and the principles of the law of agency (as elaborated by company law), there are scenarios where the law has to attribute the acts and knowledge of a company's agents by reference to more general factors.

47. Recent decisions underscore that these factors will be not just, context- and fact-specific, but they will reflect the policy considerations applicable to the situation in which the attribution has to made – in essence, what is the purpose of the claim, and what will the effect of the attribution be upon that claim?

[33] Singularis, [59].

48. This makes it more difficult to gauge how the "*special rules of attribution*" will work in certain situations, but it also allows the court to take a pragmatic approach when asked to rule on questions of attribution.

49. Although it might sometimes seem like it, attribution is not about finding a company's human *alter ego* for all purposes.

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