3 Stone Buildings Presentation: Guilty Knowledge

The rule in Hampshire Land

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Introduction

1. The purpose of this paper is to consider the scope of the rule in Hampshire Land particularly in the light of the recent House of Lords decision in *Stone & Rolls Ltd v Moore Stephens*.

Hampshire Land (decided July 1896)

2. The facts of *In re Hampshire Land Co* [1896] 2 Ch. 743 were that money was lent by a building society to the company. The secretary of both the building society and the company was the same person, Mr Wills. He knew that there was an irregularity in the consent given in general meeting by the company's shareholders because they had not been informed in the notice calling the meeting that the borrowing was in excess of the directors' borrowing powers without shareholders' consent. The building society sought to prove in the liquidation of the company, but the liquidator objected on the grounds that Mr Wills's knowledge of the irregularity was to be imputed to the society. Vaughan Williams J held that the society was entitled to prove.

3. He held:-

   (1) At page 748 that: "*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*".

   (2) At page 749 that: "*The case is very much more like the one which both Mr Bramwell Davis and Mr Jenkins had to admit was an exception to the general rule that they sought to lay down, for they admitted that 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. It seems to me that if you assume here that Mr Wills was guilty of irregularity – a breach of duty in respect of these transactions, the same inference is to be drawn as if he had been guilty of fraud. I do not know, I am sure, whether he was guilty of actual fraud; but whether his conduct amounted to fraud or breach of duty, I decline to hold that his knowledge of his own fraud or of his own breach of duty is, under the circumstances, the knowledge of the company".

JC Houghton & Co v. Nothard, Lowe & Wills (decided November 1927)

4. In *JC Houghton & Co v. Nothard, Lowe & Wills* [1928] A.C. 1 the House of Lords held by a majority that a company could not be said to be estopped from denying the validity of a transaction entered into by two of its directors in excess of their authority on the basis that the knowledge of the two directors in question was to be imputed to the company.

5. Viscount Dunedin said (at page 14):-

> "*The person who is sought to be estopped is here a company, an abstract conception, not a being who has eyes and ears. The knowledge of the company can only be the knowledge of persons who are entitled to represent the company. It may be assumed that the knowledge of directors is in ordinary circumstances the knowledge of the company. The knowledge of a mere official like the secretary would only be in the knowledge of the company if the thing of which knowledge is predicated was a thing within the ordinary domain of the secretary's duties. But what if the knowledge of the director is the knowledge of a director who is himself particeps criminis, that is, if the knowledge of an infringement of the right of the company is only brought home to the man who himself was the artificer of such infringement? Common sense suggests the answer, but authority is not wanting*".

6. Viscount Dunedin held (at page 5) that the Hampshire Land principle applied to the case before him: "*The only knowledge brought home to the company is through the Lowes [the two directors in question] and*

the secretary. They were all parties to the arrangement, which was a fraud on the true interests of the company".

7. Viscount Sumner said (at page 18):-

> "*In the case of a natural person, if information is intelligibly conveyed to and received by him, its source, whether a servant or a stranger, whether he is high or low, matters little, if at all. With an artificial incorporated person, it must necessarily be otherwise, for an impersonal corporation cannot read or hear except by the eyes and ears of others. Who are to be the organs, by which it receives knowledge, so as to affect its rights, may be specially determined by the articles of its constitution, but otherwise, in a matter where knowledge may lead to a modification of the company's rights according as it is or is not followed by action, the knowledge, which is relevant, is that of the directors themselves, since it is their board that deals with the company's rights. The mind, so to speak, of a company is not reached or affected by information merely possessed by its clerks, nor is it deemed automatically to know everything that appears in its ledgers. What a director knows or ought in the course of his duty to know may be the knowledge of the company, for it may be deemed to have been duly used as to lead to the action, which a fully informed corporation would proceed to take on the strength of it*".

8. He then referred to the exceptions to the general rule of attribution and, said (at page 19):-

> "*It has long been recognized that it would be contrary to justice and common sense to treat the knowledge of such persons as that of their company, as if one were to assume that they would make a clean breast of their delinquency. Hence, for the purposes of estopping the company, some knowledge other than theirs has to be brought home to other directors, who can be presumed not to be concerned to suppress it. This was laid down, following earlier cases, in <u>In re Hampshire Land Co</u>., and was even then treated as incontestable. So far as I know, it has never been doubted since*".

<u>Kwei Tek Chao v. British Traders & Shippers (decided July 1954)</u>

9. In *<u>Kwei Tek Chao v. British Traders & Shippers</u>* [1954] 2 Q.B. 459 words on a bill of lading had been forged as part of a conspiracy to which a firm called "*Slootmakers*", who were the defendant sellers'

forwarding agents, were a party. One question before Devlin J was whether the defendants were answerable for the fraud of Slootmakers, their agents. Devlin J rejected as too broad the submission that, since Slootmakers were the defendants' agents, they were, without more, responsible for the fraud. He said (at page 471):-

> "*A limited company has to act through agents, and if the person who presents the bills of lading knows that they are untrue and he is an agent, that is an end of the matter; but that is not suggested here. The person who presented the bills of lading and made the representation upon which the credit was obtained was Barclays Bank, and no one suggests that the bank was fraudulent*".

10. The judge held that, although Slootmakers had "guilty" knowledge of the true state of the facts and were the defendants' agents, their knowledge could not be imputed to the defendants as a result of the *Hampshire Land* principle. He said:-

> "*On the findings which I have already made the defendants were innocent of fraud, or of any complicity in the fraud. It follows, therefore, that they were the people upon whom in the first instance the fraud was being practised, and Slootmakers were, by making themselves a party of the forgery of the bills of lading, deceiving their own employers. It makes no difference that the employers might pass it on to the plaintiffs, and that they in turn might pass it on to somebody else*".

Belmont Finance Corporation v. Williams Furniture (decided February 1977)

11. In *Belmont Finance Corporation v. Williams Furniture* [1979] 1 Ch. 250 the important question was whether the company was a party to an alleged conspiracy to commit an unlawful act (namely, the provision of financial assistance for the purchase of its own shares) so that it could not bring a claim against the other conspirators for the return of the money paid by it.

12. Buckley LJ declined to hold that the knowledge of the directors that the transaction was illegal should be imputed to the company. He said (at page 261):-

13. " *... 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 a victim of the conspiracy, I think it would be irrational to treat the directors, who were allegedly parties to the conspiracy, notionally*

as having transmitted this knowledge to the company; and indeed it is a well-recognised exception from the general rule that a principal is affected by notice received by his agent that, if the agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal".

PCW Syndicates v PCW Reinsurers (decided July 1995)

14. In *PCW Syndicates v. PCW Reinsurers* [1996] 1 W.L.R. 1136 the question was whether the absence of any disclosure of the dishonesty of employees of an underwriting agency (who had misappropriated premiums received for the benefit of various Lloyd's Names) was a circumstance which entitled reinsurers to avoid various reinsurance policies for non-disclosure.

15. It was common ground that sections 18 and 19 of the Marine Insurance Act 1906 codified the common law applicable to all classes of insurance:-

    (1) Section 18 provides, in essence, that the insured principal must disclose every material circumstance known to him and that he is "*deemed to know every circumstance which, in the ordinary course of business, ought to be known by him*."

    (2) Section 19 provides, in essence, that where the insurance is effected by an agent, the agent must disclose every material circumstance which he knows and that he is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him.

16. The issues for the Court of Appeal were, therefore:-

    (1) Whether the Lloyd's Names were deemed to know of the dishonesty of their agents pursuant to section 18; or

    (2) Whether the agents' own knowledge of their dishonesty was sufficient to entitle the reinsurers to avoid the policies pursuant to section 19.

17. In relation to the first issue, Staughton LJ said that Lord Hoffmann's speech in *Meridian Global Funds Management Asia v Securities Commission* [1995] 2 A.C. 500 was authority for the proposition that "*the extent of the knowledge of a company can only be determined by reference to the rule of law which makes the inquiry necessary*" (page 1142). Staughton LJ concluded that, in order to determine what a company knows for the purposes of section 18 of the Marine Insurance

Act 1906 (which deals with what a principal must disclose to an insurer), it was not appropriate to restrict the enquiry to the knowledge of those who could be described as the directing mind and will of the company. Nevertheless, he held that the fact that the company's agents were defrauding it was never something which it could be said that the company ought to know in the ordinary course of business.

18. Although he reached that conclusion on the basis of statutory construction alone, Staughton LJ also considered what the position would be if section 18 were to be regarded as a "*rule of law that attributes or imputes knowledge or treats knowledge as being in someone's possession when it is not*". He held that the *Hampshire Land* principle was an exception to that rule which produced the same result as his construction of section 18. Staughton LJ:-

(1) Said that the modern formulation of the *Hampshire Land* principle is to be found in the judgment of Buckley LJ in *Belmont Finance Corporation v Williams Furniture* [1979] Ch 250 at pages 261-2:-

> " *... it is a well-recognised exception from the general rule that a principal is affected by notice received by his agent that, if the agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal*".

(2) Rejected the argument that the *Hampshire Land* principle should yield to the sentiment of Lord Mansfield CJ in *Fitzherbert v. Mather* (1785) 1 Durn. & E. 12 to the effect that "*where a loss must fall on one of two innocent parties through the fraud or negligence of a third, it ought to be borne by the party by whom the person guilty of the fraud or negligence has been trusted or employed*". Staughton LJ considered that this sentiment was not a rule of law in itself, "*and if it is, it must yield to the more specific rule in the Hampshire Land case…*". Where the latter rule applies, "*the judge is bound to apply it, and not Fitzherbert v. Mather*."

19. When he turned to section 19, Staughton LJ rejected the argument that the rule in *Hampshire Land* did not apply because the statute did not operate by imputing, attributing or deeming the knowledge of the agent to be that of the principal. He said that this would:-

> " *... create a remarkable difference between section 18 and section 19, and I can see no warrant for it. If the dishonesty of an agent is not something which in the ordinary course of business ought to be known to the principal (section 18), why should it be held against the principal merely because the agent*

is an agent to insure (section 19)? It is equally absurd in either case to suppose that the agent will in fact disclose his dishonesty, whether to his principal or to the proposed reinsurer.

I would hold that the Hampshire Land principle is not confined to cases where the agent's knowledge is by law to be imputed or attributed to the principal, or deemed to be the knowledge of the principal. The doctrine should extend to any case where the principal's rights are affected if the agent does not make disclosure to a third party".

20. Staughton LJ also said that the same result was arrived at on the basis that an agent's knowledge of his own fraud was not knowledge held by him in his capacity as an agent. At page 1147 he said:-

> "*I do not find in the authorities any decision that an agent to insure is required by section 19 to disclose information which he has received otherwise than in the character of agent for the assured; and certainly none where the information was as to the agent's own fraud on his principal. I would hold that he is not, whether it be by a branch of the Hampshire Land principle or because he is not an agent for that purpose*."

Group Josi Re v. Walbrook Insurance Co (decided October 1995)

21. An identically constituted Court of Appeal also decided *Group Josi Re v. Walbrook Insurance Co* [1996] 1 W.L.R. 1152. Although the issues in the latter case went wider than those in *PCW*, there was again an argument that reinsurance contracts could be avoided as a result of the failure of the underwriting agency company to disclose the misappropriation, by three of its directors, of overriding commissions.

22. Staughton LJ pointed out that the position was slightly different from that in *PCW* because:-

    (1) The underwriting agency had played some part in placing the reinsurance contracts, whilst in *PCW* this was wholly done by brokers; and

    (2) The directors of the underwriting agency were, in some cases, also directors of the insured companies.

23. Nevertheless, Staughton LJ said (at page 1162) that:-

    (1) Even if the underwriting agency had been agents to insure, the contracts could not be avoided because the knowledge of the

three directors: "*was not held in the capacity of agents for the [insured] companies, or alternatively did not give rise to non-disclosure by reason of the Hampshire Land principle or an extension of it*".

(2) In so far as the knowledge of the directors of the insured companies might be imputed to them on the basis that the directors were the guiding mind and will of the companies, there was no evidence to establish the necessary facts. This meant that it was "*unnecessary to decide whether the Hampshire Land principle or any extension of it applies to knowledge which is that of the company itself, under the first part of section 18, although Belmont Finance Corporation v Williams Furniture ... does suggest that even knowledge of directors may not be knowledge of the company under that principle*".

24. Saville LJ considered whether the knowledge of the three alleged fraudsters could be attributed to the reinsured companies on the "guiding mind and will" basis and concluded that the *Hampshire Land* principle applied. He said (at page 1170):-

> "*Mr Bartlett [for the reinsurers] accepted that there were circumstances in which the 'fraud exception' meant that knowledge was not attributed. In his submission, the essence of the relevant principle is that the court will not infer that a company has knowledge of a fact known to an agent or director of the company where, because of the agent's or director's fraud or other breach of duty to the company,* ***it would be contrary to justice and common sense to draw such inference****.*
>
> *For the purposes of this case at least, I am prepared to proceed on the basis of this proposition. Where I part company with Mr Bartlett's argument is his further submission that in the circumstances of this case it would not be contrary to justice and common sense to draw the inference. Even assuming that the alleged fraudsters or any of them fell within a class of persons whose knowledge could be attributed to the reinsured companies, I am simply unable to accept that as a matter of justice and common sense the reinsured companies should have attributed to them, either directly or through attribution to [the underwriting agent] the knowledge of the alleged fraudsters that they were being defrauded, so as to require them, in order to effect valid reinsurance, to disclose that state of affairs to the reinsurers"* (emphasis in the original).

25. Saville LJ also held that the knowledge of the alleged fraudsters could not be imputed to the underwriting agent company for the same

reasons.

Arab Bank v. Zurich Insurance (decided June 1998)

26. In *Arab Bank v. Zurich Insurance* [1999] 1 Lloyd's Rep. 262, the managing director of a company ("JDW") had made a number of fraudulent valuations in the company's name. Rix J had to consider whether the knowledge of the managing director (who was not the directing mind and will of the JDW) should be imputed to JDW for the purposes of deciding whether a professional indemnity insurance policy could be avoided for non-disclosure. Although much turned on the construction of the relevant policy, Rix J considered the rules of attribution (outside the contractual context) at some length. Having considered whether there could be attribution under the *Meridian* principles (and concluded that there could not), he then held that the *Hampshire Land* principle would, in any event, have prevented the imputation of knowledge.

27. Having cited *Hampshire Land*, *JC Houghton*, *Belmont Finance*, *PCW*, and *Group Josi*, Rix J said (at 282, Col. 2):

> "*I regard those last two authorities, when considered together, as deciding that in the insurance context,* ***as outside it****, 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 to deemed to know, to the extent that his knowledge is of his own acting in fraud of his company; and that for these purposes it does not matter whether the director is to be regarded as an agent to insure or not…*" (emphasis added).

28. Rix J then considered whether the *Hampshire Land* doctrine was confined to the case where the principal was himself the victim of the fraud. He first accepted on the facts that JDW was a victim, "*even if only a secondary victim, of the assumed fraud*". But, he concluded that:-

> "*There remains the question ... whether the Hampshire Land doctrine is confined to cases of fraud where the principal himself is the victim of the fraud, or whether, as Mr Justice Vaughan Williams put it in Hampshire Land itself, the doctrine extends to other breaches of duty where common sense would destroy the inference of transfer of knowledge. In the typical case in which the doctrine has been applied, Houghton, Belmont, PCW and Group Josi, fraud has been found or assumed. In the present*

case, fraud is also assumed, but the primary victim of the fraud has been the lending institution which has relied on the valuation. I would accept, however, the plaintiffs' submission that JDW was also a victim, even if only a secondary victim, of the assumed fraud. One consequence of the assumed fraud has been JDW's liability to the plaintiffs, albeit in negligence. Moreover, even if it could be said that JDW, unlike the plaintiffs, was not the victim of Mr Browne's fraud, Mr Browne has, on the assumed facts, been guilty of dishonesty, and one can hardly visualize a graver dereliction of his duty to his company. Although the cases often involve fraud, Hampshire Land itself did not necessarily do so, and I note that in Group Josi Re Lord Justice Saville was prepared to accept as a working definition of the scope of the principle the cases of "the agent's or director's fraud or other breach of duty to the company" (at p. 367). In my judgment, Mr Browne's fault comes within the concept of an agent's fraud on his principal, but, even if it does not, his fault is such a breach of duty to JDW as in justice and common sense must entail that it is impossible to infer that his knowledge of his own dishonesty was transferred to JDW."

McNicholas Construction Co Ltd v. Customs and Excise Commissioners (decided June 2000)

29. In *McNicholas Construction Co Ltd v. Customs and Excise Commissioners* [2000] STC 553, Dyson J considered whether an employee's dishonest acts in the preparation and submission of VAT returns should be attributed to his employer. Companies and individuals purporting to act as sub-contractors of the claimant company ("MC") had fraudulently issued VAT invoices to MC for services they had not supplied. MC's site managers were involved in the fraud. MC subsequently claimed input tax relief in respect of these invoices. Customs investigated MC and issued assessments in 1997 for VAT arrears in respect of various periods between June 1990 and March 1996. Such an assessment could only be made more than three years after the end of the relevant accounting period if the conduct of the person liable for the VAT involved dishonesty within the meaning of section 60 of the VAT Act 1994.

30. One of the questions before the Court was whether the knowledge of the site managers that deductions for input tax would be made could be attributed to MC. In this context, there was an immaterial argument concerning the effect of section 61 of the VAT Act. In addition, MC argued that the site managers' knowledge could not be attributed under the "guiding mind and will" principles but that, if it could otherwise be

attributed, the rule in *Hampshire Land* applied since the site managers were involved in a fraud on the true interests of MC.

31. On the "*guiding mind and will*" issue, Dyson J applied Lord Hoffmann's dicta in *Meridian* and commented (at paragraph 44):-

> "*In some cases, the acts or defaults of the 'directing mind and will' of the company, or at least those of the 'directing mind and will' of its relevant functions, will be attributed to the company. In others, the acts or defaults of other employees who cannot be said to be the 'directing mind and will' are to be attributed. The question in each case is whether attribution is required to promote the policy of the substantive rule, or (to put it negatively) whether, if attribution is denied, that policy will be frustrated*."

32. Dyson J held that the policy of the relevant sections of the VAT Act would be seriously undermined if the acts and knowledge of those employees who have a part to play in the making and receiving of supplies were not to be attributed to the company.

33. As to the *Hampshire Land* principle, Dyson J said:-

> "*The Hampshire Land principle or exception is founded in common sense and justice. It is obvious good sense and justice that the act of an employee should not be attributed to the employer company if in truth, the act is directed at, and harmful to, the interests of the company. In the present case, the fraud was not aimed at the company. It was not intended by the participants in the fraud that the interests of the company should be harmed by their conduct. In judging whether the fraud was in fact harmful to the interests of the company, one should not be too ready to find such harm … Looking at the facts of this case from a common sense point of view, there was no VAT fraud or harm to the interests of the company*."

Bank of India v Morris (decided June 2005)

34. *Bank of India v Morris* [2005] BCC 739 is one of many cases concerned with the fallout from the collapse of BCCI. Mr Samant, a senior manager (but not a director) of the Bank of India, committed it to a series of transactions which amounted to assisting BCCI to defraud its creditors. The Court of Appeal upheld Patten J, who had held that Bank of India liable under section 213 of the Insolvency Act 1986. As in *McNicholas* the statutory context guided the court's approach to the appropriate rule of attribution and the Court of Appeal said:-

"As in McNicholas, the acts of Mr Samant were not in fact targeted at BoI. He was acting for, and in what he apparently believed to be the interests of BoI in seeking to gross up the balance sheet for the purposes of the year end accounts. The potential liability of BoI under s 213 is irrelevant in deciding whether BoI was a victim of Mr Samant and whether his knowledge should be attributed to it for the purposes of s 213."

Stone & Rolls Ltd v Moore Stephens (decided July 2009)

The Facts

35. S & R, a company registered in England, was dormant when in 1995 it came under the control of Mr Stojevic who was in sole control of S & R and (through artificial arrangements set up in the Isle of Man) effectively the beneficial owner of its share capital. He was the mastermind behind a fraudulent scheme.

36. The fraudulent scheme was effected by means of letters of credit issued by a Czech bank, Komercni Banka AS ("KB") in favour of S & R at the request of an Austrian company named BCL Trading GmbH ("BCL"). BCL was controlled by Mr Barak Alon, who appears to have been an accomplice of Mr Stojevik. Payment under the letters of credit was obtained by the presentation of false documents certifying the existence in distant warehouses of non-existent stocks of agricultural produce. These payments were promptly passed on to BCL, which initially met its obligation to KB, so building up its confidence. Eventually however there were 30 letters of credit (totalling $94m) for which KB was not reimbursed. About $80m of this was promptly passed on to BCL, or companies connected with it, and it has never been traced.

37. KB obtained judgment against S & R and Mr Stojevic for the $94m. Provisional liquidators of S & R were appointed on 15 November 2002 followed by a full winding-up order on 15 January 2003.

38. Mr Stojevic had planned to use S & R to perpetrate the fraud before he engaged Moore Stephens as S & R's auditors. Indeed the engagement of Moore Stephens was part of his plot. S & R, which was not at the material time carrying on any significant business, had an auditor who was a sole practitioner in Rotherhithe. Mr Stojevic decided to replace him with Moore Stephens as part of a strategy to make S & R appear

respectable in the eyes of European Banks. In persuading Moore Stephens to become S & R's auditors, Mr Stojevic gave a fictitious account of the business that S & R had been doing and of the business whose accounts Moore Stephens would be auditing.

39. In these proceedings S & R sued Moore Stephens for breach of contract and in negligence seeking to recover losses caused to S & R in consequence of the extension of the period of its fraudulent activity as a result of Moore Stephens' failure to discover the fraud when it was alleged they should have done.

40. Moore Stephens applied to strike out the claims because it was founded on Mr Stojevic's 's fraud and was met by the defence of ex turpi causa. S & R argued that its liability for Mr Stojevic's fraud was vicarious (in which case it was accepted that the defence of ex turpi causa would not apply); that in any event the rule in Hampshire Land meant that Mr Stojevic's fraud could not be attributed to it; and that the defence of ex turpi causa did not apply because Mr Stojevic's fraud was the very thing that Moore Stephens were under a duty to prevent.

41. Moore Stephens accepted that they owed S & R a duty to exercise reasonable skill and care in carrying out their duties as auditors and for the purposes of the strike out application accepted that they were in breach of those duties and that, but for their breach, the fraud that Mr Stojevic was perpetrating through S & R w

The decision of the Courts below

42. Langley J held that S & R were primarily and not vicariously responsible for the fraudulent conduct, that the Hampshire Land principle did not apply and that Mr Stojevic's fraud was properly attributed to S & R. However he held that ex turpi causa could not prevent a claim founded on fraud that would not have occurred had Moore Stephens properly complied with their duty as auditors of the company because the fraudulent conduct of Mr Stojevic's fraud was "the very thing" that Moore Stephens should have detected.

43. In the Court of Appeal Rimer L.J. gave the leading judgment. He agreed that S & R were primarily liable for the fraudulent conduct. He also agreed that the Hampshire Land did not apply. He held that the crucial question was whether it was right to treat S & R as the villain or the victim. In the former case the fraud would be attributed to S & R; in the latter case it would not. He held that S & R was the villain and not the victim, Hampshire Land did not apply and ex turpi causa was a defence to S & R's claim.

44. Rimer L.J. rejected S & R's argument based on the principle described as "the very thing". He accepted the submission made on behalf of Moore Stephens that this was a principle that related to causation that did not displace the operation of the defence of ex turpi causa.

The Opinions of the Committee

45. The House of Lords was divided. For different reasons they held by a majority of 3 – 2 that the appeal should be dismissed and the claim against Moore Stephens struck out.

46. Lord Phillips held that:-

(1) The essential question is how the principle of ex turpi causa applies to a claim by a company against those whose breach of duty has caused or permitted the company to commit fraud that has resulted in detriment to the company.

(2) The answer to that question did not depend upon the application of Hampshire Land or any similar principle of attribution.

(3) It depended upon whether, in applying ex turpi causa, the Court should look behind the company at those whose interests the relevant duty is intended to protect.

(4) On the extreme facts of this case, it was not necessary definitively to resolve that question. Those for whose benefit this claim is brought (namely the creditors of S & R) fall outside the scope of any duty owed by Moore Stephens. The sole person for whose benefit such duty was owed, being Mr Stojevic who owed and ran the company, was responsible for the fraud.

(5) In those circumstances ex turpi causa provides a defence to the claim.

47. Lord Walker and Lord Browne also held that the appeal should be dismissed but not for the same reasons as Lord Phillips. They held:-

(1) Hampshire Land does not apply because Mr Stojevic's fraudulent conduct is to be treated as the conduct of S & R.

(2) That was because on the particular facts of this case Mr Stojevic was not only the directing mind and will of S & R but also its owner.

(3) In the premises ex turpi causa defeats S & R's claim.

48. Lord Scott (dissenting) found 2 different reasons for allowing the appeal.

(1) What he called "the procedural reason" was because in the absence of a trial and factual findings he did not consider that he was in a position to conclude that Mr Stojevic was the absolute beneficial owner of the S & R shares. If he was not, then arguably the corporate veil could not be lifted and Mr Stojevic's knowledge could not be attributed to S & R.

In addition he held as a "substantive reason" that:-

(2) The ex turpi causa rule is a procedural rule based on public policy.

(3) If S & R had remained a solvent company an action against Moore Stephens that would have enabled Mr Stojevic to benefit from any damages that were recovered would have offended the ex turpi causa rule.

(4) The position would be different if Mr Stojevic was a shareholder but not the sole shareholder. In such a case an action against Mr Stojevic and the auditors would not be barred by ex turpi causa. There would be no reason for public policy to require the auditors to be relieved of liability for their breach of duty. The action, assuming it succeeded against both defendants could be expected, via contribution proceedings, to leave Mr Stojevic with no benefit from any damages recovered from the auditors.

(5) In the present case where S & R is insolvent and will stay so whatever damages are recovered from the auditors, the need to ensure that Mr Stojevic does not benefit from any damages does not present a problem. In the premises there is no reason why ex turpi causa, a rule based on public policy, should apply since public policy is not even engaged.

49. Lord Mance (also dissenting) held that:-

(1) If Mr Stojevic had not been the sole shareholder in S & R ex turpi causa would not apply because there would be no question of Mr Stojevic benefiting from his own wrong and it would be nonsensical to attribute his wrong to the company in such circumstances. In such circumstances Hampshire Land would apply because S & R had to be considered as a separate legal entity from Mr Stojevic and Mr Stojevic's conduct could

properly be regarded as a fraud on S & R.

(2) In fact Mr Stojevic was the sole shareholder in S & R. If S & R had been solvent there might have been difficulty in establishing any claim against Mr Stojevic. However because S & R was insolvent, Mr Stojevic was in breach of duty in failing to have regard to the interests of the creditors. S & R would have been able to sue him for breach of this duty and ex turpi causa could not be relied upon as a defence.

(3) If S & R had had independent shareholders rather than Mr Stojevic alone, S & R could claim against Moore Stephens and ex turpi causa could not defeat such a claim for failing to detect the very fraud that was asserted by way of defence.

(4) The critical factor is that S & R was insolvent. Just as Mr Stojevic was in breach of his duty to have regard to the interests of the creditors, so, in circumstances where S & R was insolvent, the auditors' duty to the company extended beyond the interests of the shareholders to the interests of the creditors and ex turpi causa affords no defence to breach of this duty.

Where are we now?

50. Hampshire Land remains good law. It applies as an exception to the normal rules for the attribution of an agent's knowledge. It is not a rule about the attribution of conduct. Hampshire Land applies where an agent has knowledge which his principal does not in fact share but which under normal principles of attribution would be deemed to be the knowledge of the principal. The effect of Hampshire Land is 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 the 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.

51. The rule in Hampshire Land usually arises in the context of fraud but in principle it can be applied to any breach of duty to the principal. That is clear from Hampshire Land itself and *Arab Bank*.

52. The principal does not have to be the primary victim of the fraud. It can be a secondary victim in the way the company was in *Arab Bank*. As a result of the managing director's fraud the company was exposed to liability to the banks. Therefore whilst the banks were the primary victims the company was a secondary victim.

53. However it appears from the judgments of Lord Walker and Lord Brown in *Stone & Rolls Ltd* that where all who have ownership and control of a company are complicit in a fraud carried out by the company there is no room for the application of the rule in Hampshire Land. In such circumstances the knowledge of the fraudster or fraudsters simply is the knowledge of the company and the company cannot be classified as a victim of the fraud as opposed to the vehicle of the fraud.

54. However the position may not be quite so straightforward. What if such a company went into liquidation (eg S & R) and the liquidator commenced a misfeasance summons against the fraudster (Mr Stojevic)? Surely, in those circumstances, Mr Stojevic could not defeat such a summons by attributing his knowledge of the fraud to the company. In such a circumstance the rule in Hampshire would surely be invoked.