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**THE WISDOM OF *SALOMON*?
THE TORT DUTIES OF
DIRECTORS OF ONE-PERSON COMPANIES**

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The wisdom of Salomon?



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*Te Whare Wananga
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law, namely: to cause people to live honestly, not to harm others and to give each their due.

Word Length

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 23,000 words.

ABSTRACT:

The decision in *Trevor Ivory* seems premised on an unexplained deference to the case of *Salomon* and company law generally. However, the concept of a limited liability company is only a metaphor. *Salomon* can be heavily criticised at several levels. It should be seen in its historical, social and political context. The law of tort has developed significantly since 1897. *Salomon* is only a case, the same as any other. It should not be afforded reverential treatment other than on its intrinsic merits. Those merits should be fully examined.

The decision in *Trevor Ivory* is wrong and the law should be correspondingly reformed. While reform of company law may be inadequate in this area, it would be quite appropriate, and indeed essential, to reform the law of tort to restore a better balance. Arguably, the law of tort already indicates that *Trevor Ivory* is wrong. However, the case of *Trevor Ivory* is still good law. It should be overruled.

Limited liability is a privilege, not a right. It should not blind us to the *purposes* of the law, namely: to cause people to live honestly, not to harm others and to give each their due.

Word Length

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 25,000 words.

THE WISDOM OF *SALOMON*?

THE TORT DUTIES OF DIRECTORS OF ONE-PERSON COMPANIES

The main policies behind *Salomon* lie in the logic of the original statutory scheme of the companies' legislation and a freedom of contract...approach. This arguably tipped the pendulum too far away from creditor protection and exposed involuntary creditors at least [such as claimants in tort] to excessive risk. This approach neglected the fundamental principles of the law as stated by *Justinian* in relation to Roman Law over a thousand years ago – *Honeste vivere, alterum non laedere, suum cuique tribuere* – the purposes of the law are to cause people to live honestly, not to harm others and to give each their due. As a consequence, the strict application of *Salomon*...has led to a system of limited liability...which was never countenanced by the early legislation and has facilitated abuses...¹

I INTRODUCTION

It is often said that the doctrine of limited liability has been a major instrument in making possible the industrial and commercial developments which have occurred throughout the world;² without limited liability companies, the world's railways would not have been built.³ However, the benefits of the doctrine have their costs. Indeed, the merits of the doctrine of limited liability have been the subject of passionate disagreement by "otherwise level-headed commentators" ever since its general availability in the middle of last century.⁴

The 1992 case of *Trevor Ivory Ltd v Anderson*⁵ illustrated one of the difficulties of the doctrine of limited liability: how should the doctrine interact with the law of tort, particularly where a negligent person has acted through a one-person company? Should tort law or company law take precedence? Should the law seek to right a wrong, or is limited liability unimpeachable in

¹ John H Farrar "Legal Issues Involving Corporate Groups" (1998) 16 *Company and Securities Law Journal* 184, 200 (bracketed words added).

² Gower *Principles of Modern Company Law* (5 ed, 1992), 70.

³ See below n 18.

⁴ Paul Halpern, Michael Trebilcock and Stuart Turnbull "An Economic Analysis of Limited Liability in Corporation Law" (1980) 30 *University of Toronto Law Journal* 117, 117 ["Halpern"].

⁵ *Trevor Ivory Ltd v Anderson* (1992) 2 NZLR 517 (CA) [*Trevor Ivory*].

this context? Conclusions as to where the line should be drawn or which law should take priority often seem to depend on one's starting point.

In the *Trevor Ivory* case, Mr and Mrs Anderson sought the advice of Mr Ivory regarding couch grass that was growing in their raspberry orchard. Mr Ivory indicated that he would like to put his advice "through his company"; Mr and Mrs Anderson were ambivalent on this point so long as Mr Ivory did the work. Mr Ivory advised the Andersons to use Roundup and one of their employees carried out his advice "to the letter". The entire raspberry crop died.

Obviously, Mr Ivory did not seek to make good the Andersons' loss because a case was stated for the High Court. The High Court found the advice to be negligent and held Mr Ivory's company liable in contract and tort. Mr Ivory was also found to be *personally liable* in negligence. Mr Ivory appealed.

The Court of Appeal upheld the finding of the negligence against the company but overturned the finding against Mr Ivory personally: Mr Ivory was found *not* to have owed a *personal* duty to the Andersons to take care.

Most companies in New Zealand are small and typically carry little in the way of capital. Initial incorporation may be effected with as little as \$1 and profits are customarily fully debited out as salary. Where a small company is in the "advice" business, its asset-backing may be particularly low as such businesses require almost no capital assets to run: the only real "asset" of an advice business is the personal knowledge of the proprietor and any tangible assets that are required, such as a telephone or a fax, may even be rented. A finding against such a company is therefore of little practical effect as there will be no money with which to meet the claim. Consequently, the finding that Mr Ivory was not personally liable for what was effectively his negligence meant that the destruction of the Andersons' raspberry crop, devastating as it was, had to be borne by the Andersons themselves, without compensation. Mr Ivory is free to set up another company (or companies), and under the same

circumstances the only moderator would be his personal integrity.⁶ The law did not require recourse to his personal wealth to make good the consequences of his negligence.

It is a decision many people are uncomfortable with.⁷

The limited liability company as a concept is essentially a legal artifice – a “metaphorical use of language which entails certain legal consequences.”⁸ Metaphors in law are to be narrowly watched, “for starting as devices to liberate thought, they often end by enslaving it.”⁹ This paper considers the doctrine of limited liability from a historical and an economic perspective, before considering the foundation case of *Salomon*.¹⁰ The paper questions whether the Court of Appeal were correct in giving such primacy to *Salomon* (to the unexplained exclusion of a conventional tort analysis), particularly given the shaky foundations of that case, its questionable merit in terms of one-person companies and its questionable application to victims of tort.

The recent House of Lords’ decision in *Williams*¹¹ provides an interesting comparison with the *Ivory* case, and may assist in its ultimate overruling.

From a policy perspective, the *Trevor Ivory* decision is wrong. The purpose of this paper is to consider possible avenues by which something could be done

⁶ The standards for disqualification of directors under ss 151(2), 382, 383 and 385 of the Companies Act 1993 seem quite high, mostly relating to criminal convictions or undischarged bankruptcy. Disqualification of a person may occur on the basis that their company failed (s385), but only if the Registrar is satisfied that the manner in which the *affairs of the company were managed* was wholly or partly responsible for the failure of the company (s385(4)(a)). Even if the negligence in the *Ivory* case constituted “management” of the affairs of the company sufficient to cause Mr Ivory to be disqualified, (which seems unlikely), any such disqualification lasts for a maximum of five years only.

⁷ Todd (ed) *The Law of Torts in New Zealand* (2 ed, Brookers, Wellington 1997), 372 [“Todd”]: “it is difficult to regard *Ivory* as a satisfactory decision”. See also GHL Fridman “Personal Tort Liability of Company Directors” (1992) 5 *Canterbury Law Review*, 41 [“Fridman”].

⁸ Farrar and Russell *Company Law and Securities Regulation in New Zealand* (Butterworths, Wellington, 1985), 47 [“Farrar and Russell”].

⁹ *Berkey v Third Avenue Railway*, 244 NY 843, 94-95 per Cardozo J.

¹⁰ *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL) [*Salomon*].

¹¹ *Williams and Another v Natural Life Health Foods Limited and Mistlin* [1998] 1 WLR 830 (HL) [*Williams*].

about it. Possible avenues might include a reform of company law to remove the ability of one-person businesses to obtain the privilege of limited liability. This would be more consistent with the historical and economic foundations of limited liability and would solve the problem caused by the *Ivory* case. Alternatively, reform might be effected through the law of tort.

II COMPANY LAW

Limited liability is commonly thought of today as such an integral part of the corporate form that to challenge it is “recklessly revolutionary”.¹² However, the doctrine is of recent origin, having evolved over only the last 150 years or so. What is “limited liability” in this context, and how has our law come to grant such a blanket privilege?

A Limited Liability

“Limited liability” in this context is the principle through which the shareholders of an insolvent company do not have to contribute their own money to the assets in the liquidation to meet the debts of the company:¹³

The starting point is the liability of the company...The liability of the company for its various debts is unlimited; in an insolvent liquidation, where the debts over-top the assets available, all of the assets will be used up in satisfying the claims of creditors and not all creditors will be paid in full...The liability of the shareholders is limited, but it is necessary to be careful about in what sense it is limited...they are not liable at all for the company's debts...[They] have a liability to contribute to the assets of the company in the event of its assets in the liquidation being insufficient to meet the claims of the creditors. It is this liability which is limited. The liability is...limited to the amount ‘unpaid’ on the shares...[plus of course the amount already contributed].

¹² Henry Hansmann and Reinier Kraakman “Toward Unlimited Shareholder Liability for Corporate Torts” (1991) 100 Yale LJ 1879, 1923 [“Hansmaan”].

This principle is enshrined in section 97 of the Companies Act 1993:

...a shareholder is not liable for an obligation of the company by reason only of being a shareholder...the liability of a shareholder of a company is limited to ...any amount unpaid on a share by the shareholder...

In other words, once a person has invested money in a company in exchange for shares, the amount of that investment is the total amount that the shareholder has at stake.¹⁴ In an *unlimited* liability situation, all of a person's wealth is at stake on acquisition of a share in a company. Should the venture for which the company was created prove so unsuccessful that liquidation of the company is sought, all of the assets of all of the shareholders could be called on to make good any unsatisfied company debts.¹⁵

B *A Common Historical Model of the Company*

The doctrine of limited liability has its origins in quite a different time and circumstance.¹⁶

Prior to the 19th century, much trading in Britain was carried on without limited liability through various adaptations of the partnership form.¹⁷ The members of joint stock companies, for example, had unlimited joint and several liability for all corporate obligations.

The commercial matrix altered in the 19th century as the industrial revolution developed exponentially. There were railways to be built, not only in England

¹³ Ben Pettet "Limited Liability - A Principle for the 21st Century?" [1995] Current Legal Problems 125, 126 ["Pettet"].

¹⁴ In the ordinary course of events, that is, barring liability as a director or in any of the other more unusual circumstances described in s 97.

¹⁵ Although, if pro rata rather than joint unlimited liability is chosen, each shareholder would only be liable in proportion to his or her number of shares in the company.

¹⁶ David W Leebron "Limited Liability, Tort Victims and Creditors" (1991) 91 Columbia LR 1565, 1566 ["Leebron"].

but also in America, and the shipping industry was burgeoning. Projects were bigger, and entrepreneurs needed to amass capital to undertake them; more capital was needed than any average entrepreneur was able to amass in a personal capacity. Large numbers of people had to be persuaded to invest in order to finance the proposed ventures.

However, the social context of the time meant that entrepreneurs were having difficulty in effecting this persuasion. The successes of the joint stock companies had seen such a rapid increase in their popularity that the market had become flooded with them. Many wealthy British investors had been badly burned in the inevitable "correction", amid much publicity. Passive investment had come to be seen as dangerous:¹⁸

"To be a 'sleeping partner' without limited liability, would be exceedingly dangerous", and accordingly persons will only invest in a firm with unlimited liability where they can control the riskiness of the firm's activities and also monitor the wealth of their co-adventurers. This combination would make it impossible for large aggregations of wealth to be assembled at least in the private sector...

However, it *was* possible to achieve limited liability at a micro level:¹⁹

At present the law...is that every ostensible partner who shares the profits of a trading concern renders himself liable in the whole of his property to the whole of its debts; but in practice...all the partners contract with each other, and the company contracts with every person it deals with, that all claims shall be confined to the subscribed fund of the company. Every person with whom it deals entering voluntarily into the contract, the principle of limited liability is, by common consent, fully carried out, whatever the law may say to the contrary.

¹⁷ Pettet above n 13, 130.

¹⁸ Dan Prentice "Insolvency: Inroads into Corporate Personality in the Insolvency Context" in *Conference Papers – "A Centenary Celebration of Salomon" Conference* [1997] 4 ["Prentice"].

¹⁹ *Economist*, 1 July 1854, cited in Halpern above n 4, 117.

Nevertheless, the industrialisation which was perceived as being important to Britain at that time was unlikely to occur without private financial support. The potential providers of that financial support, who could clearly see the potential *personal* returns an investment in that industrialisation might bring, were in a position of political power:²⁰

The law is so dangerous and unjust towards a man of substance, by putting his whole property at the mercy of other persons beyond his control, if he does join a joint stock company, that very few men of respectability can be found to occupy so perilous a position.

In addition, the political pressure for a general limited liability regime coincided with a prevailing political ethic of laissez-faire. In such an environment, when limited liability was already being contracted for at a micro level anyway, it was argued that the law should simply provide “maximum freedom of contract and...minimise the transaction costs incurred by parties in achieving mutually desired allocations of risk”²¹.

The pressure proved successful: in 1855, the Limited Liability Act was passed granting limited liability to companies generally.

However, this political achievement was accomplished amid much controversy. *The Times* of London, for example, stated that:²²

Nothing can be so unjust as for a few persons abounding in wealth to offer a portion of their excess for the information of a company, to play with the excess – to lend the importance of their whole name and credit to the society, and then should the funds prove insufficient to answer all demands, to retire into the security of their unhazarded fortune, and leave the bait to be devoured by the poor deceived fish.

²⁰ Pettet above n 13, 145.

²¹ Halpern above n 4, 119.

²² *The Times*, London, editorial 25 May 1824, cited in Halpern above n 4, 117.

The *Law Times* described the legislation as a “Rogues Charter”,²³ it had been rushed through Parliament, and was later criticised for its “oracular” style, “leaving to the courts the interpretation of its mystical utterances”.²⁴

C *The Legal Theory of Separate Corporate Personality*

Precisely what the Legislature had meant by the concept of general limited liability was tested some 40 years later in the case of *Salomon*.²⁵

1. *The facts of Salomon*

Aron Salomon was a boot manufacturer who had been trading as a successful sole trader in the East End of London for over 30 years. In 1892 he formed a company to which he sold his business. His reasons for incorporating might never be known, but might have included pressure from his family to give them a share in his business.²⁶

Under the Companies Act 1862 (a successor to the Limited Liability Act of 1855), incorporation, and therefore limited liability, could be obtained by “Any seven or more persons associated for any lawful purpose”. Mr Salomon set up the shareholding of “Salomon & Co Ltd” in order to comply with the legislation, taking 20,001 shares himself; his wife, daughter and four sons one share each as nominees for Mr Salomon.

Of course, the company had no money with which to meet the purchase price of Mr Salomon’s business. Mr Salomon therefore “loaned” it £10,000 in return for £10,000 of debentures, or IOU’s, secured on the company’s property.²⁷

²³ Pettet above n 13, 131.

²⁴ Sir Frederick Pollock (1897) 13 *Law Quarterly Review* 6.

²⁵ *Salomon*, above n 10.

²⁶ This point is mentioned in Farrar and Russell above n 8, 45.

²⁷ The actual purchase price was £39,000, £30,000 of which was to be paid for out of money as it came in, which Mr Salomon was to immediately return to the company in exchange for fully paid shares. As only 20,001 shares were issued, it seems the remaining £8,999 was never paid to Mr Salomon by the

The company fell on hard times, and lasted only a year before it failed. It is said that there was a great depression in the trade and boot workers on whom Mr Salomon depended went on a succession of strikes ("Trade unionism was becoming a power in the land"²⁸). In an attempt to get the company back on its feet, Mr Salomon mortgaged his debentures for £5,000, which money was promptly loaned to the company. The company continued to fail, however, and was finally put into liquidation.

The liquidator sold off the assets of the company, and had sufficient funds to take only one of two possible courses of action:

- (a) Either the liquidator could favour the debentures, that is, meet the claim of the mortgagee and pay the remaining funds (£1,077) over to Mr Salomon himself, as beneficial owner of the debentures (Mr Salomon had only mortgaged the £10,000 in debentures to the extent of £5,000, meaning that Mr Salomon was still owed at least £5,000 under them); or
- (b) The liquidator could use the funds to meet the amounts owed by the company to its unsecured trade creditors (£7,734).

Of course, Mr Salomon's secured debentures took preference over the unsecured creditors' claims. In an attempt to satisfy the latter, however, the liquidator argued that the debentures were invalid on the grounds of fraud. He also argued that the board of the company, if there was one, consisted entirely of Mr Salomon, meaning there was never an independent board.²⁹

company. However, the purchase price was acknowledged as representing the "sanguine expectations of a fond owner rather than anything that can be called a businesslike or reasonable estimate of value". See Farrar and Russell above n 8, 46.

²⁸ Lord Cooke *Turning Points of the Common Law* (Sweet & Maxwell, London, 1997), 7 [*Turning Points*].

At first instance, Vaughan Williams J looked upon the case with a “jaundiced eye. He disapproved of the one-[person] company which was...[then] a new practice and thought he detected fraud”.³⁰ However, the evidence established no fraud; indeed, all the members of the company had been fully aware of the terms on which the company had purchased the business, and had accepted those terms.³¹

On his Lordship’s suggestion, a new argument was added to the counterclaim, namely that the company was merely Mr Salomon’s *agent and nominee*. As such, Mr Salomon as principal was required to *personally* indemnify the liquidator for the sum of the unsecured debts. In other words, Mr Salomon’s liability was not held to be limited. Mr Salomon appealed.

Lindley LJ of the Court of Appeal also considered a one-person company to be an abuse of the Companies Act.³²

The formation of the company, the transfer of the business and the issue of the debentures, were a mere scheme to enable Mr Salomon to carry on business in the name of the company with limited liability contrary to the true intent and meaning of the Companies Act 1862, and to enable him to obtain a preference over other creditors by procuring a first charge over the company’s assets by means of the debentures.

However, feeling some difficulty in describing the company as Mr Salomon’s agent, his Lordship instead characterised Mr Salomon as a *trustee* for the company which was his mere shadow. Mr Salomon’s liability was again held not to be limited. Mr Salomon appealed.

²⁹ David Goddard, “The Development of the Treatment of Corporate Personality from *Salomon* to *Meridian*” in *Conference Papers – “A Centenary Celebration of Salomon” Conference* [1997] 5 [“Corporate Personality”].

³⁰ Farrar and Russell above n 8, 46 (footnotes omitted).

³¹ “Corporate Personality” above n 29, 5.

³² “Corporate Personality” above n 29, 6.

2. *A purposive approach*

Lord Cooke has spoken of the unquestionable company law pedigree of the judges in the two lower courts.³³ Both lower instance judges recognised that the legislature had never contemplated an extension of limited liability to sole traders. Statutorily-limited liability had developed to attract investors, in order that large, often industrial projects, might be facilitated through the amalgamation of capital. The associated companies were generally characterised by a separation of ownership and control; that is, the investors generally did not carry out the day-to-day business of the company themselves. Although there were seven shareholders in Mr Salomon's company, it was clear that six of them were shareholders "simply in order to enable the seventh himself to carry on business with limited liability".³⁴ In Mr Salomon's company, there was no "amalgamation of capital" facilitating the undertaking of a large project that would not otherwise be undertaken. There was no separation of ownership and control. The legislature should perhaps have made its intention more clear, however, those familiar with the company law legislation of the time knew that:³⁵

...the founders of the company law legislation, in using the word "associated" meant such an association as, without the help of the statute, would have made the persons members of an *ordinary partnership*, with unlimited personal liability.

If a court of 1990s New Zealand were faced with the *Salomon* situation, it might instead have resorted to a "purposive approach" in order to give effect to the true intention of the legislature. A brief description of what is meant by a "purposive approach" follows.

³³ *Turning Points* above n 28, 8.

³⁴ *Turning Points* above n 28, 7.

³⁵ Sir Frederick Pollock (1897) 13 LQR 6, cited in *Turning Points* above n 28, 8 (emphasis added).

Section 5(j) of the Acts Interpretation Act 1924 states that legislation in New Zealand today is to be given such a “fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Act...[according to its] true intent, meaning and spirit”.

This provision predicates an approach to legislation based on the scheme and relevant objects of the legislation. It requires:³⁶

...a careful reading *in its historical context* of the whole statute, analysing its structure and examining the relationships between the various provisions and recognising any discernible themes and patterns *and underlying policy considerations*.

Lord Cooke of Thorndon has spoken of the appropriateness of a “determination to find out the intention of Parliament”.³⁷ His recent extrajudicial comments on the case of *Lee v Lee's Air Farming Ltd*,³⁸ the other pillar of New Zealand company law,³⁹ illustrate this.

In the *Lee* case, the Privy Council held that a shareholder of a one-person company was *separate* from the company itself, thus enabling the company to “employ” him, and the shareholder's wife to receive compensation for his work-related death. Arguably, this slight misapplication of the doctrine of separate corporate personality (the fact that a shareholder is separate from the company arguably says nothing about the status of a director, even when both statuses are intertwined in one person) was necessary in order to achieve justice in the case. Lord Cooke has stated that, were the question in *Lee* to arise before a court today, it might instead be solved “by a more overt

³⁶ *CIR v Challenge Corporation Ltd* (1986) 2 NZLR 513, 549 per Richardson J (emphasis added). See also the leading case of *CIR v Alcan NZ Ltd* (1994) 3 NZLR 439, 442 where *Challenge* was approved and it was stated that the proper approach is *to ascertain the true meaning*: “The true meaning must be consonant with the words used, having regard to their context in the Act as a whole, *and to the purpose of the legislation* to the extent that this is discernible” (emphasis added).

³⁷ *Turning Points* above n 28, 9.

³⁸ *Lee v Lee's Air Farming Ltd* [1961] AC 12 (PC) [*Lee*].

invocation of the *policy* of the Workers' Compensation Act [such policy being compensation for work-related accidents]...[as] nothing in the scheme or purpose of the Act justified excluding the deceased and his family".⁴⁰ The principle in the *Lee* case should be viewed in this light.

Similarly, if a purposive approach had been adopted in *Salomon*, it would have been easy, and indeed appropriate, for a court to find that Mr Salomon and his family were not "associated" in the sense intended by the Act; the company that was formed was not such that was intended by the legislature to have the privilege of limited liability. In other words, Mr Salomon could have been found personally liable for the debts owed to the unsecured creditors on a simple interpretation of the legislation without invoking the "legal gymnastics" of either agency or trusteeship.

However, the prevailing interpretative ethic of the late 19th century was what might be termed a "black letter form of statutory interpretation". As Mr Salomon and his family were "associated" in a *familial* sense, the black letter of the legislation was arguably complied with. The lower courts were left to "agency" and "trusteeship" tools in order to try to give effect to the intention of the legislature.

This is arguably "calamitous".⁴¹

3. *The House of Lords' decision*

The lower court judges arguably reached the right result, but with the wrong doctrine. The House of Lords had little difficulty in overturning Lindley LJ's "trusteeship" finding, and, with respect, this must be right. To have held that

³⁹ Cooke P seems to consider *Salomon* and *Lee* as the two pillars of company law: *Trevor Ivory* above n 5, 523.

⁴⁰ *Turning Points* above n 28, 11 (emphasis added).

⁴¹ To quote Sir Otto Kahn Freund's description of the House of Lords' reaching of the very result the lower courts were striving to avoid. See (1994) 7 MLR 54, cited in *Turning Points* above n 28, 8.

shareholders by definition are trustees for their companies, or indeed that companies by definition are agents for their shareholders, would have stymied much that is of value of the corporate form.

Instead, their Lordships simply invoked the prevailing black letter interpretative method of the time and held Mr Salomon *not* personally liable for the unsecured contractual creditors of the insolvent company. Possibly in response to the argument that the company was an “agent” for Mr Salomon, the House of Lords held that this one-person company was instead a “real thing”, separate from Mr Salomon himself. The creditors were *its* creditors, not Mr Salomon’s. The company had to honour its debentures to Mr Salomon, and Mr Salomon was not liable for the debts of the company. His liability was limited:⁴²

Their Lordships’ speeches...are not profound analyses of the nature of corporate personality. They do not delve into the social and legal rationale for limited liability, let alone the economics of that institution. They read like a simple exercise in statutory interpretation. The company, they point out, was formed and registered in accordance with the statute. The statute did not say any more than that there must be seven shareholders – and there were....The policy identified by the Court of Appeal prohibiting “one-[person] companies” was to be found nowhere in the Act...Provided the statutory formalities were complied with, the company existed.

Almost as an accident of history, therefore, the case of *Salomon* permitted the incorporation of a one-person business.

4. Discussion

The decision in *Salomon* was heavily criticised at the time. Higgins in *The Law of Partnership* stated that:⁴³

⁴² “Corporate Personality” above n 29, 6.

Seldom has the entire House of Lords sunk to such a level of jurisprudential ineptitude as to reject the clear intention of the legislature in favour of the application of the so-called literal rule of interpretation. The decision in... [*Salomon*] has probably done more to undermine commercial integrity in sixty years than did the Statute of Frauds in nearly three hundred.

Other academic commentary argued that:⁴⁴

... no-one who knew anything of the earlier history of the Companies Acts could doubt that such a decision as had now been given would have been impossible 30 or even 20 years previously.

Further, the decision was thought to result in the company becoming “a means of evading liabilities and concealing the real interests behind the business”.⁴⁵

Salomon is today hailed as authority for the “separate identity” principle, now enshrined in section 15 of the Companies Act 1993.⁴⁶ This principle has been elevated to almost god-like status; limited liability has been likened to such a “birthright” of corporations that any proposals for its limitation or abolition are treated “as if such proposals would undermine the foundation of modern industry”.⁴⁷

However, this is odd given that much is unsatisfactory about the case. The black-letter form of statutory interpretation on which it is based has fallen into some disrepute in a modern “purposive” era, and it is unlikely that a court of 1990s New Zealand would reach the same result. The decision runs counter to the policy of the relevant companies’ legislation of the time. The privilege of limited liability was never intended to be afforded to small one-person

⁴³ Higgins (1963), 16 cited in Halpern above n 4, 119.

⁴⁴ Sir Frederick Pollock, (1897) 13 LQR 6, cited in *Turning Points* above n 28, 8.

⁴⁵ Professor Otto Kahn Freund (1944) 7 MLR 54, cited in Halpern above n 4, 119.

⁴⁶ “A company is a legal entity in its own right separate from its shareholders and continues in existence until it is removed from the New Zealand register”.

⁴⁷ Leebron above n 16, 1569.

companies, with no separation of ownership and control, no accumulation of capital, and no real offsetting benefit in terms of contribution towards the industrialisation of Britain.

Despite this, the *Salomon* decision seems to have gained a life of its own, independent from and “ectopic”⁴⁸ to its individual holdings. The decision needs to be re-examined from a policy perspective and, as with any case of any century, should not be afforded reverential treatment other than on its intrinsic merits.

Three points should be noted on any such re-examination. Firstly, the separate identity principle holds that the company is separate from its *shareholders*. The 19th century legislators might have had in mind larger companies, with a separation of ownership and control, but nevertheless the principle is silent on the status of *directors* vis-à-vis either shareholders or the company itself. Mr Salomon was not held to have transgressed in his capacity as a director, but simply that his liability as *shareholder* was limited.

Secondly, the courts could have laid down a “separate corporate identity” principle without granting that privilege in the *Salomon* case. That this is the case is borne out by the vast quantities of examples of situations where courts have since found it necessary to “pierce the veil” despite the existence of the principle. Limited liability is not actually a necessary consequence of recognition of separate corporate legal personality: it is quite possible to incorporate a *separate* legal entity which has *unlimited* liability.⁴⁹

Thirdly, the creditors who were ultimately held liable to bear the bulk of Mr Salomon’s losses were trade creditors, or “contract” creditors. No “tort” debts were at issue.

⁴⁸ To borrow the term used in a perhaps-related context by Professor Prebble.

⁴⁹ See for example s 97 of the Companies Act 1993 which specifically envisages *unlimited* liability companies.

III THE INTERACTION OF COMPANY LAW AND TORT

The doctrine of separate corporate personality and limited liability raises some interesting issues at the interface with the law of tort. This was evidenced by the case of *Trevor Ivory*.

The question in *Ivory* concerned whether Mr Ivory, a director of a one-person company, owed a personal duty of care in addition to the duty owed by the company itself. It was argued that a personal duty of care would erode the principle in *Salomon*. That is, to find Mr Ivory personally liable when he acted *as* the company would effectively mean that his liability as a *shareholder* was not limited, at least with respect to the loss caused to the person harmed by the negligence. He and the company would not be effectively “separate”.

The extent of a director’s personal liability for torts has traditionally followed normal tortious principles:⁵⁰

An individual is liable for his own tortious conduct, and the mere fact that he commits a tort while on his principal’s business does not relieve him of liability. In particular, the idea that company directors were to be treated “any more kindly than the servant” was thought by Slade LJ to “offend common sense” (*C Evans & Sons Ltd v Spritebrand*).

The Court of Appeal case of *South Pacific*⁵¹ presented a multi-faceted approach to the determination of the existence or otherwise of a duty of care. That case, like *Ivory*, involved a negligent misstatement made in the context of a close contractual nexus. Their Honours specifically listed the “integrity

⁵⁰ Ross Grantham “Company Directors and Tortious Liability” [1997] Cambridge LJ 259, 260.

⁵¹ *South Pacific Manufacturing Co Ltd v New Zealand Security Consultants and Investigations Ltd* (1992) 2 NZLR 282 (CA) [*South Pacific*].

of other legal principles” (such as the concept of limited liability) as a factor to be taken into account.⁵² Cooke P (as he was then) stated that:⁵³

...when a duty of care issue arises in a situation *not clearly covered by existing authority* the proper approach is to look at all the material facts in combination, in order to decide as a question of mixed law and fact whether or not liability should be imposed.

Despite this, their Honours mentioned *South Pacific* only in passing. It will be necessary to return to *South Pacific* later.

Of course, to the extent that the relevant act concerned negligent misstatement, the situation in *Trevor Ivory* was covered by existing authority. The House of Lords held in *Hedley Byrne*⁵⁴ that if someone possessed of a “special skill undertakes, quite irrespective of contract, to apply that skill for someone who relies on it” then a duty to take care in statement will arise.⁵⁵

Hedley Byrne was a ground-breaking decision. Traditionally, courts were reluctant to impose liability in the area of negligent misstatement for fear of “opening the floodgates”. It was felt that reasonable people may make statements with less care than they afford their physical actions. Further, statements could be repeated a number of times without the defendant being able to disclaim the accuracy of the information. Finally, negligent misstatements were more likely than other negligent acts to create financial or “pure” economic loss. Negligence cases involving financial loss had traditionally been particularly controversial “due in no small measure to the very considerable difficulty in drawing recognisable and coherent boundaries to liability”.⁵⁶

⁵² Indeed, this was one factor which ultimately led to the finding that there was no duty of care in that case.

⁵³ *South Pacific* above n 51, 293 (emphasis added).

⁵⁴ *Hedley Byrne & Co v Heller & Partners Ltd* [1964] AC 465 (HL) [*Hedley Byrne*].

⁵⁵ *Hedley Byrne* above n 54, 502 per Lord Morris.

In keeping with this view, the lower court in *Hedley Byrne* had held that a duty to take care in statement would only arise where there was a fiduciary relationship, an express or implied term in a contract, or some other *special relationship* which gave rise to a duty of care. The reference given by the bank to the advertising agency met none of those criteria.

In overturning this finding, the House of Lords held that a relationship may be “special” enough to give rise to a duty to take care in making a direct statement to a plaintiff⁵⁷ where:

- (a) the plaintiff was relying on the advice;
- (b) it was reasonable for the plaintiff to so rely; and
- (c) the defendant knew or ought to have known that the plaintiff was relying on him or her.

The banker’s reference situation was therefore sufficient to create a duty because the advertising agency had clearly reasonably relied on the defendants’ advice and had done so to the defendants’ knowledge. Nevertheless, no liability ultimately arose because the advice was issued “without responsibility on the part of this bank”. In other words, a reasonable disclaimer was held to be sufficient to avoid a duty of care.

The New Zealand courts considered *Hedley Byrne* in 1975 in the case of *Capital Motors*.⁵⁸ In that case, it was held that a used-car salesperson owed a duty to take care in giving information to a buyer concerning the number of previous owners of a car. Cooke J (as he was then) held that the relationship was sufficiently special to give rise to a duty because, in such a situation, there had been an assumption of responsibility by someone who ought to be in a position of knowledge.

⁵⁶ Todd above n 7, 11.

⁵⁷ Or a plaintiff’s agent.

⁵⁸ *Capital Motors Ltd v Beecham* (1975) 1 NZLR 576 (SC) [*Capital Motors*].

Further, an exclusion condition in the contract of sale did not amount to a sufficient disclaimer of liability:⁵⁹

...the relevance of such a condition in tort, as shown in *Hedley Byrne*, is that it may be part of the material from which one deduces whether a duty of care was assumed... This is a question of fact and there is no finding... that either the purchaser or the salesman even had it in mind when the latter undertook to check and convey the alleged result of doing so... On the facts of this case I do not think that the condition negated a duty of care.

In 1983, in *Meates v Attorney-General*,⁶⁰ the Court of Appeal held that the situation of a politician making statements concerning government policy called for special skill and knowledge. Further, the politician-defendant had held himself out as possessing that special skill or knowledge. A duty of care was owed.

The damage caused in *Meates* was financial only, but this could not preclude a duty on the part of the Crown: any such argument would be an "anachronism".⁶¹ Further, Cooke J (as he was then) considered it "artificial" to distinguish between statements and other actions: "the duty of the Government... was to take reasonable care, both in what was said and in what was done".⁶²

Consequently, at the time of the *Trevor Ivory* case, it was sufficient in New Zealand for a duty to arise to take care in a statement given directly to a plaintiff⁶³ if the advice was given in a professional capacity or in the ordinary course of business, with knowledge that the plaintiff was relying on the advice and where it was reasonable for the plaintiff to so rely.

⁵⁹ *Capital Motors* above n 58, 580 per Cooke J.

⁶⁰ *Meates v Attorney-General* [1983] NZLR 308 (CA) [*Meates*].

⁶¹ *Meates* above n 60, 378 per Cooke J.

⁶² *Meates* above n 60, 379.

More recently, the House of Lords set down some governing principles in the area of negligent misstatement in the case of *Henderson v Merritt Syndicates*.⁶⁴ It will be necessary to return to this case later as well.

The cases of *Caparo*⁶⁵ and *Scott Group*⁶⁶ concern negligent misstatements which were not made *directly* to the plaintiffs. Instead, the plaintiffs in those cases relied on auditors' reports contained in financial statements. In considering whether defendants owe a duty of care in such indirect circumstances, the inquiry into the knowledge of the defendant is more tightly focused:

- (i) did the defendant know that the statement would be communicated directly or indirectly to the class of plaintiffs of which the plaintiff was a member;
- (ii) was the defendant fully aware of the nature of the transaction the plaintiff had in contemplation;
- (iii) did the defendant know it was very likely that the plaintiff would rely on the advice in deciding whether or not to enter into the transaction.

These additional requirements may be thought of as a desire to avoid auditors' liability "of an indeterminate amount for an indeterminate time to an indeterminate class".⁶⁷

Mr Ivory gave his advice *directly* to the plaintiffs in the ordinary course of business, aware (or he ought to have been) that the particular plaintiffs were reasonably relying on it. This placed the case squarely within the *Hedley Byrne* principle as applied by *Capital Motors* and *Meates*. However, the case

⁶³ Or a plaintiff's agent.

⁶⁴ *Henderson v Merritt Syndicates* (1995) 2 AC 145 (HL).

⁶⁵ *Caparo Industries PLC v Dickman* [1990] 2 AC 605 (HL) [*Caparo*].

⁶⁶ *Scott Group Ltd v McFarlane* (1978) 1 NZLR 576 (CA) [*Scott Group*].

⁶⁷ To quote the famous phrase.

of *Trevor Ivory* had an additional complicating factor not shared by the New Zealand authorities so far mentioned. Mr Ivory acted through a company. The Court of Appeal had to address the argument that imposing liability on Mr Ivory *personally* for this negligent misstatement would mean that the limited liability he sought in forming the company would not be achieved. Or, perhaps more correctly, limited liability would be achieved generally in the sense in which it was arguably intended, that is, with respect to trade or “contract” creditors. However, it would not be achieved where the consequences of his negligent misstatements had to be made good. Counsel for Mr Ivory argued that the statement was not his, it was the company’s; Mr Ivory had acted not as himself but “as” the company; to find that he owed a *personal* duty to take care in these circumstances would undermine the principle in *Salomon*.

Tort law is said to be about compensation. Deserving plaintiffs who suffer loss as a result of a defendant’s negligence should have that loss made good, usually by an award of compensatory damages. Inherent in tort law are considerations of personal responsibility⁶⁸ for damage negligently caused. A wrong should have a remedy:⁶⁹

The liability for negligence, whether you style it such or treat it as in other systems as a species of ‘culpa’, is no doubt based upon a general public sentiment of moral wrongdoing for which the offender must pay.

This is not to say that the perpetrator of a wrong should be *punished* as that is the realm of the criminal law (and one of the arguments against the civil imposition of exemplary damages). Nevertheless, the sanction of a negligence suit is argued to provide a “deterrent effect”, or an incentive to take reasonable care. Cooke P has stated that the promotion of professional competence in this manner is an important social objective.⁷⁰

⁶⁸ Grantham above n 50, 262.

⁶⁹ *Donoghue v Stevenson* [1932] AC 562, 580 (HL) per Lord Atkin.

⁷⁰ *South Pacific* above n 51, 294 per Cooke P.

Tort law can also be described in terms of economically-efficient allocation of a negligently-caused loss. In pursuit of this aim, and often implicitly rather than explicitly, it will ask questions such as which party is in the best position to bear the loss, or to avoid the "costs" of it most cheaply? Which party is the "best briber"? Economic efficiency is concerned with overall wealth and not the distribution of it, however; there may be "distributional" considerations such as equity or justice which might nevertheless cause the loss to be allocated to the "inefficient" party.

The ground-breaking negligence case of *Donoghue v Stevenson* held in 1932, 35 years after *Salomon*, that a manufacturer owed a duty of care to a person who was harmed by their product. Crucially, this duty extended to someone who had not actually purchased their product but who had received it as a gift from a friend. In other words, the law of tort "filled in" where there was no contract between the parties themselves.⁷¹

More recently, the House of Lords considered the issue of personal duty of care of a director of a "one-person" company in the context of the direct negligent misstatement of the company. The case of *Williams and Another v Natural Life Health Foods Limited and Mistlin*⁷² presents an interesting comparison with *Ivory*.

IV THE DECISIONS IN TREVOR IVORY AND WILLIAMS

A Comparison on the Facts

The House of Lords found in the *Williams* case that the director did not personally owe a duty of care. However, both the result and the reasoning in *Williams* seem easier to accept than in *Ivory*. That this is the case might be

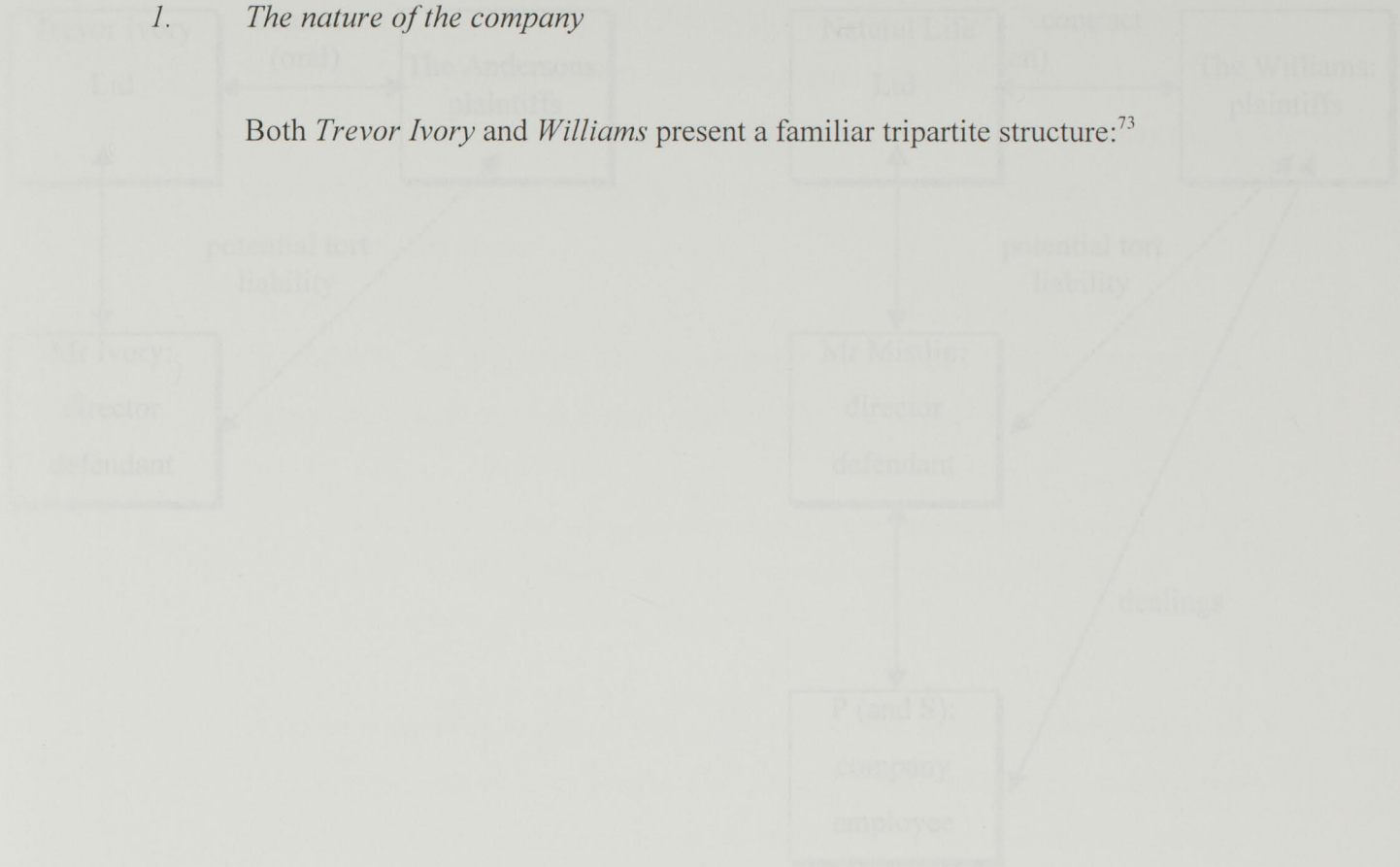
⁷¹ Todd above n 7, 531.

⁷² *Williams* above n 11. *Williams* is also approved in the case of *Donoghue v Stevenson* and *South Pacific*.

partially explained through a consideration of the nature of the company and the nature of the act done.

1. *The nature of the company*

Both *Trevor Ivory* and *Williams* present a familiar tripartite structure.⁷³



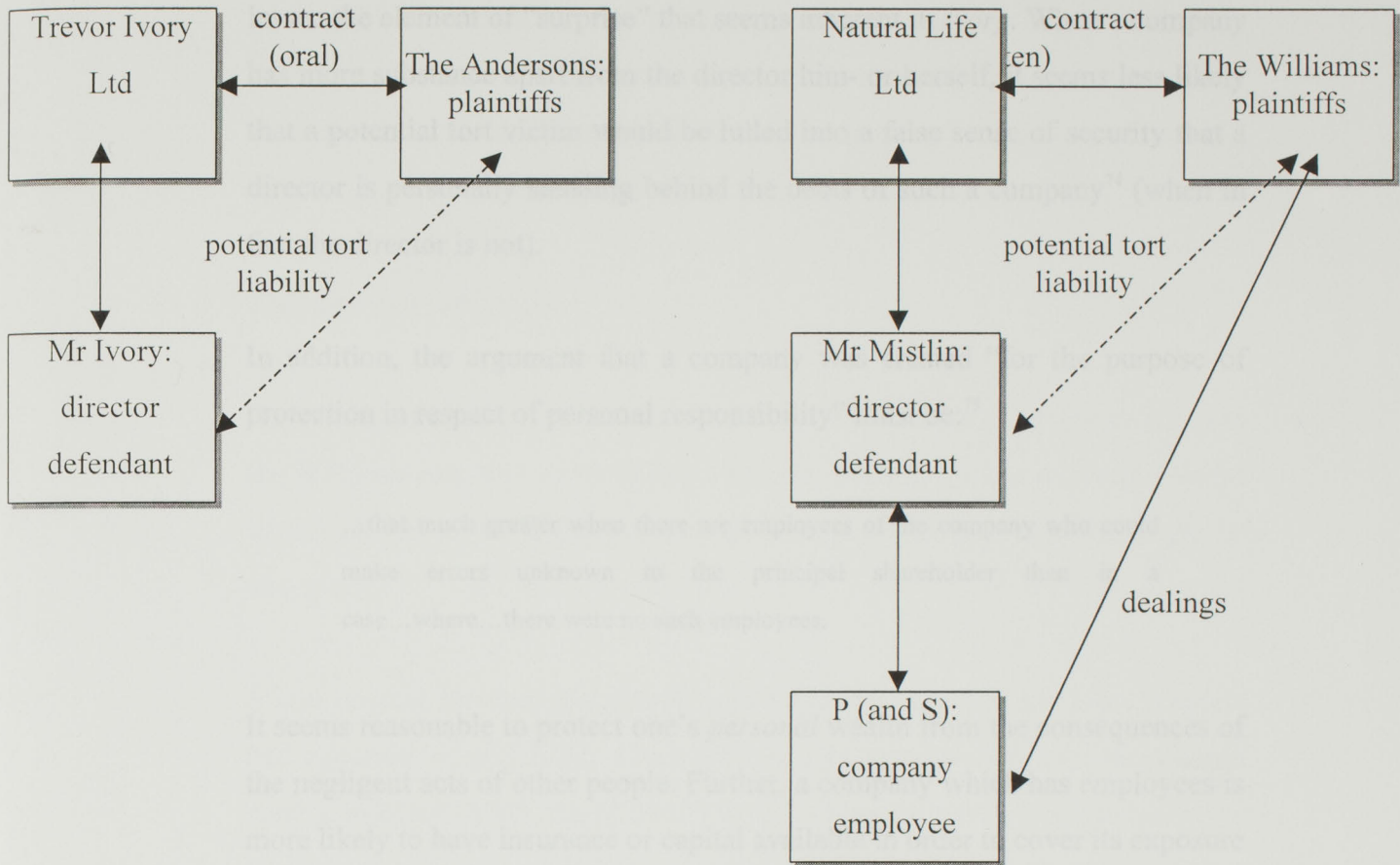
Like Mr Ivory, Mr Mistlin was director and principal shareholder of his company, Natural Life Health Foods Ltd (NLHF Ltd). Despite the existence of a nominal shareholder, both companies were effectively "one-person".

Mr Mistlin had wanted to work in the health food trade in 1960, and had owned and operated an apparently successful health food shop since 1963. In 1986, he formed a company to franchise the concept of health foods under the trade name "Natural Life Health Foods".

⁷³ A similar tripartite structure is also apparent in the cases of *Donoghue v Stevenson* and *South Pacific*.

Trevor Ivory:

Williams:



Like Mr Ivory, Mr Mistlin was director and principal shareholder of his company: Natural Life Health Foods Ltd (NLHF Ltd). Despite the existence of a nominal shareholder, both companies were effectively “one-person”.

Mr Mistlin had started to work in the health food trade in 1980, and had owned and operated an apparently successful health food shop since 1983. In 1986, he formed a company to franchise the concept of health foods under the trade name “Natural Life Health Foods”.

Unlike Mr Ivory's company, NLHF Ltd, employed two staff: S and P (and it seems the nominal shareholder was somewhat more actively involved in the business). This makes the company less "one-person" in nature, and must lessen the element of "surprise" that seems inherent in *Ivory*. When a company has more substance apart from the director him- or herself, it seems less likely that a potential tort victim would be lulled into a false sense of security that a director is personally standing behind the debts of such a company⁷⁴ (when in fact the director is not).

In addition, the argument that a company was created "for the purpose of protection in respect of personal responsibility" must be:⁷⁵

...that much greater when there are employees of the company who could make errors unknown to the principal shareholder than in a case...where...there were no such employees.

It seems reasonable to protect one's *personal* wealth from the consequences of the negligent acts of other people. Further, a company which has employees is more likely to have insurance or capital available in order to cover its exposure to vicarious liability for employees' acts. This means there is potentially more inherent coverage for a tort victim with such a company, and less need to look to a director personally.

A principal difference between the two companies, however, seems to be that Mr Mistlin's company was more clearly separate from Mr Mistlin, and more clearly a "thing" in itself. In such a situation, a plaintiff is less likely to be "hoodwinked" into underestimating the significance of the request "can I put this through the company?" (particularly in the context of invoices that refer to a director's services *personally*).

⁷⁴ See Prentice above n 18, 35 for a discussion of this point in the context of company groups.

⁷⁵ *Livingstone v Bonifant* (1995) 7 NZCLC 260,657, 260,665 per Doogue J cited in Andrew Borrowdale "Liability of Directors in Tort – Developments in New Zealand" [1998] *Journal of Business Law* 96, 104 ["Developments in New Zealand"].

Also, Trevor Ivory Ltd was in the business of providing *advice* and advice businesses are personal in nature almost by definition. It seems reasonable for a plaintiff to rely on a director of a one-person company for advice paid for in the course of this sort of business (certainly in comparison to the type of business that was conducted by Mr Mistlin's company). This point is returned to later.

2. *The nature of the act done*

Of course, irrespective of the nature of the two businesses, the advice given in the *Williams* case was quite different to, and given in quite a different context to, the advice given in *Ivory*. Some discussion of the two contexts might be necessary.

Initial contact between the plaintiffs in the *Ivory* case and Mr Ivory himself had occurred in late 1982, when Mr Ivory's company had sold them some sprays. In March 1983, the plaintiffs were looking for a consultant to take over where their previous consultancy company had left off; they wanted someone to be responsible for regular supervision of their raspberry orchard, and for all important decisions relating to the management of the crops.⁷⁶ The Ivory family name and indeed Mr Ivory himself were known to Mr Anderson as being well recognised in the field.⁷⁷ Mr and Mrs Anderson therefore approached Mr Ivory to work with their manager on a back-up basis. Mr Ivory agreed, although there was no discussion of fee or contractual arrangements.⁷⁸ Later in 1983 this matured into an oral contract between Trevor Ivory Ltd and the plaintiffs for the provision of consultancy services in return for an annual fee of \$5000. Sprays and fertilisers were also to be supplied by the company and paid for as required.

⁷⁶ *Trevor Ivory* above n 5, 530.

⁷⁷ *Trevor Ivory* above n 5, 531.

⁷⁸ *Trevor Ivory* above n 5, 531.

The company's invoices contained exemption clauses, however, these were found to apply to products supplied only and not to the advice. In addition, while the invoices for the annual advice fees were on company letterhead, they referred to "consultancy fees 'for' or 'by' TA Ivory".⁷⁹ This represented to the plaintiffs that they were receiving Mr Ivory's *personal* advice.⁸⁰ Indeed, it had been important to the plaintiffs to have "personal involvement" by Mr Ivory, their consultant;⁸¹ it was the personal or one-person aspect of his business which had appealed to them.⁸²

In 1985, the plaintiffs sought Mr Ivory's advice under the agreement regarding the couch grass which they thought threatened the raspberry crop. The advice to use Roundup was found to have been negligent in that it omitted to include an instruction to cover the vines and/or mow the grass before spraying the weedkiller on it.

The context in the *Williams* case, on the other hand, is quite different. The plaintiffs in that case, Mr Williams and Mrs Reid, approached Mr Mistlin's new company with a view to obtaining a franchise to open a health food shop in Rugby. They asked for and were given a brochure which described the company's team in glowing terms and extolled Mr Mistlin's previous successes in the health food trade. The company also sent detailed financial projections to the plaintiffs which demonstrated the suitability of the proposed premises and the likely future profitability of their shop. All material pre-contractual documents were on company letterhead.

Encouraged by and relying on this advice, the plaintiffs entered into a written contract with the company in 1987 through which they purchased a franchise to open their health food shop.

⁷⁹ *Trevor Ivory* above n 5, 524 per Cooke P.

⁸⁰ *Trevor Ivory* above n 5, 524.

⁸¹ *Trevor Ivory* above n 5, 531 per McGechan J.

⁸² *Trevor Ivory* above n 5, 525 per Heron J.

The advice which was found to have been negligent in the *Williams* case was principally that the projections were inaccurate. The plaintiffs' shop closed within 18 months, having made a loss of some £31,000 instead of a projected profit of £38,000.⁸³

A personal duty of care was disputed in the *Ivory* case because Mr Ivory had "at no time held himself out as engaging in the supply of agricultural or horticultural materials and the accompanying advisory service other than by way of this limited liability company".⁸⁴ His evidence was that he was consciously trading through his company, on advice, bearing in mind the possible risks involved in the spray business.⁸⁵ It was found that Mr Ivory had at some unspecified time asked if he could "put the [advice] charges through his company",⁸⁶ which request was accepted by the plaintiffs, understanding that Mr Ivory would be the "man on the ground". The Andersons wanted the expertise which Mr Ivory carried in his head and were unconcerned with the formalities of the legal relationship as long as Mr Ivory himself did the actual work.⁸⁷ However, in the final analysis, it seems fair to say that "neither the plaintiffs nor the company thought about what each other considered was the nature of the legal relationship involved".⁸⁸ Neither seems to have turned their mind to the perception of the other,⁸⁹ and in the normal course of events, so long as Mr Ivory did the work and the company was paid, it would not have mattered.

The personal duty of care was disputed in *Williams*, however, because the plaintiffs did not know and had not dealt with Mr Mistlin personally in any

⁸³ Andrew Borrowdale "Directors' Liability for Corporate Misstatements" (1997) 3 NZ Business Law Quarterly 211, 212 ["Corporate Misstatements"].

⁸⁴ *Trevor Ivory* above n 5, 531 per Heron J.

⁸⁵ *Trevor Ivory* above n 5, 531. The trial Judge also found that tax reasons were not the motivation for Mr Ivory confining contractual relationships to the company.

⁸⁶ *Trevor Ivory* above n 5, 531.

⁸⁷ *Trevor Ivory* above n 5, 532.

⁸⁸ Fridman above n 7, 54.

⁸⁹ *Trevor Ivory* above n 5, 532.

pre-contractual matters of importance; instead they had dealt through an independent consultant and an employee of the company. In fact, Mr Mistlin had no direct role in the commission of the tort: the financial projections had been compiled by the independent consultant⁹⁰ (although Mr Mistlin had seen and approved them before they were given to the plaintiffs).

The relationship between the parties in the *Williams* case has more of a character of a one-off arms'-length investment deal, than the ongoing business relationship of the *Ivory* case. The Williams received advice from a party who was clearly biased as the very nature of the NLHF business was to persuade people to invest in the NLHF concept. There is likely to be "puffery" in such a situation and this factor alone should have been sufficient to put the plaintiffs in *Williams* on their guard. Indeed, they did seek independent legal advice (at least in relation to the franchise contract).⁹¹

Both sets of plaintiffs suffered loss as a result of a negligent misstatement. In both cases, the lower court(s) found that the company and the director personally were liable to the plaintiffs. Both directors appealed against the findings of personal liability.

The lower courts in the *Williams* case had had to deal with the fact that Mr Mistlin had been somewhat removed from dealings with the plaintiffs. While the advice in the *Ivory* case might be characterised as having been given *directly* to the plaintiffs, Mr Mistlin's personal role in the advice might be more analogous to the "indirect" auditor cases. The trial judge in *Williams* found that the indirect nature of Mr Mistlin's involvement was immaterial⁹² because he "must have known that any potential franchisee would expect the projections to have his personal stamp of approval, based on his earlier

⁹⁰ "Corporate Misstatements" above n 83, 212.

⁹¹ David Goddard "The 1993 Act Comes Into Its Own" [1997] Company and Securities Law Bulletin 94, 94 ["Goddard"].

⁹² *Williams* above n 11, 153.

experience”.⁹³ The English Court of Appeal upheld this result: the company had held itself out as having the expertise to provide reliable advice to franchisees, and the brochure had made it clear that this expertise derived from *Mr Mistlin’s experience* in the operation of his Salisbury shop. Personal liability should be sheeted home to Mr Mistlin because the:⁹⁴

...skill and experience offered by the company were in fact to be found in Mistlin alone, since only he had had any involvement in the health food trade, and Mistlin’s experience had been acquired not in his capacity as a director of Natural Life Health Foods Ltd, but in his personal capacity.

The House of Lords had little difficulty in overturning this finding and with respect, this must be right. Focussing on the manner in which knowledge and experience had come to be acquired arguably only confuses the issue of whether a director personally owed a duty of care. By definition, knowledge and experience is personal to the person who acquired it. If the result turned on the capacity in which a director had acquired his or her relevant expertise, no company could effectively run an advice business.⁹⁵ The New Zealand Court of Appeal overturned the finding of negligence against Mr Ivory personally for different reasons. Mr Ivory was perhaps more alive now to the consequences of Roundup than he was at the time of giving the advice,⁹⁶ but nevertheless it was held that he did not *personally* owe a duty of care.

In both cases, the findings against the companies remained, however, clearly both companies were unlikely to have had sufficient funds to meet the claims against them. The plaintiffs’ loss in both cases would therefore effectively have gone uncompensated.

⁹³ “Corporate Misstatements” above n 83, 212.

⁹⁴ “Corporate Misstatements” above n 83, 213.

⁹⁵ For support for this argument see “Corporate Misstatements” above n 83, 213 and Goddard above n 91, 94.

⁹⁶ *Trevor Ivory* above n 5, 519.

The claim for compensation in *Williams* is clearly less morally strong than in *Ivory*. It has more of an air of a search for a deep pocket rather than a genuine moral feeling that *this* director should make right *this* wrong.

If negligence in the *Williams* case could be sheeted home to the consultant who actually prepared the projections, presumably the company would have been vicariously liable for that negligence. Perhaps the plaintiffs could have pursued the consultant. However, there was no reasonable reliance on Mr Mistlin personally, or on the projections at all. Projections are simply predictions, and can never be *safely* relied upon: no one can predict the future. They can be even less safely relied on in a situation where there is likely to be “puffery”.⁹⁷

The advice in *Williams* was merely one of several factors the plaintiffs should have taken into account in exercising their business judgement (as to whether to enter into this venture). It was given in order to persuade the plaintiffs to “join up”, for no payment by the plaintiffs (the payment in the case was for the franchise, the decision to purchase which had been made after the freely-given advice had been considered). Of course, the fact of payment is not determinative for the tort action. However, the fact that the advice was given gratis was another factor which should have put the plaintiffs on their guard that it was not reasonable to *rely* on it.

By contrast, it is significant that the negligent act in *Ivory* occurred in the context of a business relationship which had already been going for two years at the time the act occurred. This relationship was characterised by the significant degree of trust the Andersons had obviously placed in Mr Ivory over a period of time, evidenced partly perhaps by the fact that the contract through which the arrangement was effected was “informal”, not having been

⁹⁷ Arguably, Mr Mistlin’s business was not “promoting”, however, in which case recent New Zealand authority would indicate there would be more of a case for making a director personally liable. See *Jagwar Holdings Ltd v Julian* (1992) 6 NZCLC 68,040.

reduced to writing other than through the invoices Mr Ivory periodically produced. On any analysis, Mr Ivory, whether through his company or not, was the Andersons' "consultant", for which he was paid a significant annual retainer. They sought advice from their retained consultant in the course of an ongoing business. Mr Ivory's advice on the other hand was *reasonably* expected to be correct. It was *purchased* for the purposes of relying on it.

If the business judgement of the *Williams*' plaintiffs turns out to have been wrong, it seems reasonable that they should take some responsibility for that fact. There seems less reason for the law to support them in what seems to be a quest for "someone to blame".

B The Judgements

The comparison between the cases is particularly interesting in terms of the various approaches the judges took in reaching their conclusions of no personal liability. To some extent, an argument, that conclusions in this area of the interaction of company law and tort are often predicated by what one takes as one's starting point, is borne out by the judgements in the two cases.

1. The New Zealand Court of Appeal

(a) the starting point

The New Zealand Court of Appeal were unanimous in finding that the starting point in determining whether or not Mr Ivory personally owed a duty of care was company law. Cooke P held that:⁹⁸

In this field...it behoves the Courts to avoid imposing on the owner of a one-
[person] company a personal duty of care which would erode the limited

⁹⁸ *Trevor Ivory* above n 5, 523.

liability and separate identity principles associated with the names of *Salomon* and *Lee*.

His Honour mentioned the case of *South Pacific* only tangentially and towards the end of his judgement.⁹⁹

Similarly, and despite acknowledging that the issue in the case concerned the interaction of two competing common law principles (the doctrine of separate corporate personality on the one hand, and of allowing an adequate remedy on the other),¹⁰⁰ Hardie Boys J also favoured company law: “the starting point must obviously be *Salomon*”.¹⁰¹

On its face, the judgement of McGechan J seems more based on first-principles. The case of *South Pacific* was not mentioned, but his Honour nevertheless acknowledged that duty of care issues in a negligent word context are prima facie governed by the foundation case of *Hedley Byrne*.

However, his Honour analysed that case in an unexpected way. In *Hedley Byrne*, it was held that a reasonable person who knew he [sic] was being trusted, or his judgement and skill were being relied on, and who gave an answer *without a clear* qualification that he accepted no responsibility for it, must:¹⁰²

...be held to have *accepted some responsibility* for his answer being given carefully, or to have accepted a relationship with the inquirer which requires him to exercise such care as the circumstances require.

In other words, the standard for an assumption of responsibility, the “touchstone” of liability in the negligent word context, was decidedly low in *Hedley Byrne*. (It is confusing that his Honour also considered that assumption

⁹⁹ *Trevor Ivory* above n 5, 523 and 524.

¹⁰⁰ *Trevor Ivory* above n 5, 525.

¹⁰¹ *Trevor Ivory* above n 5, 525.

¹⁰² *Trevor Ivory* above n 5, 530.

of responsibility was the issue in the *Fairline*¹⁰³ case, as that case concerned a negligent *act* not a statement).

Analysing the *Ivory* case in terms of whether Mr Ivory had *personally* assumed responsibility for the advice given might therefore have seemed reasonably straight-forward: the Andersons had sought Mr Ivory's advice personally with respect to the orchard which constituted their livelihood; Mr Ivory knew that; the relationship generally had a decidedly personal character; in fact, the company was almost "invisible" to the Andersons; the Andersons were relying on Mr Ivory personally, to Mr Ivory's knowledge. Prima facie, there seems clearly to have been an assumption of responsibility, objectively determined, on the part of Mr Ivory.

However, McGechan found that that was not the case. Unexpectedly, his Honour distinguished *Hedley Byrne* on the facts.¹⁰⁴ There seems almost to be an assumption that the existence of a limited liability company rendered the "assumption of responsibility" test for negligent misstatement considerably higher in this context. Unfortunately, however, his Honour does not articulate that assumption.

Such an assumption certainly does not seem indicated by the authorities of *Capital Motors* and *Meates* (which were also distinguishable on the facts of *Hedley Byrne*). His Honour simply states that:¹⁰⁵

It may indeed be drawing the long bow to apply a *Hedley Byrne* approach so as to impose personal liability upon the managing director of a one-[person] company, in rural New Zealand, engaged in the high-risk business of horticultural spray advice, who has exhibited a considerable anxiety to limit liability by insulating himself through corporate protection.

¹⁰³ *Fairline Shipping Corporation v Adamson* [1975] QB 180.

¹⁰⁴ *Trevor Ivory* above n 5, 530.

¹⁰⁵ *Trevor Ivory* above n 5, 530.

However, the question of why it would not also be drawing the long bow to allocate this loss to the Andersons, who are also in rural New Zealand, who paid handsomely for the advice they received, and who had exhibited a no-doubt equally-considerable degree of anxiety to secure Mr Ivory's services *personally*, (which clear focus was acknowledged by his Honour to be "unsurprising" in an advisory relationship)¹⁰⁶ is not made clear.

Despite couching the issue in terms of a balancing between the Andersons' "clear focus" on Mr Ivory's personal services, and Mr Ivory's "clear desire" to distance himself from personal liability, it seems clear that McGechan J, as with the other members of the Court of Appeal, gives a primacy to company law:¹⁰⁷

When it comes down to an assumption of responsibility, I do not accept a company director of a one-[person] company is to be regarded as automatically accepting tort responsibility for advice given on behalf of the company by himself.

That might be the case where a director is "highly prominent" in comparison to the company, but such was not the case here (although it is difficult to see on the facts how much more highly prominent Mr Ivory could have been).

(b) the importance of the "identification" concept

Having reached a clear conclusion that company law was the starting point, Cooke P and Hardie Boys J went on to consider the "identification" concept.

Cooke P began his judgement by noting a distinction between the company law concepts of "separate identity" and "identification". However, the fact that a company is separate from its *shareholder(s)*, when dealing with questions between shareholder(s) and the company, does not inform the status of a

¹⁰⁶ *Trevor Ivory* above n 5, 531.

company and its *directors* when they deal with the outside world. This of course was the situation in *Ivory*.

Hardie Boys J also noted that *Salomon* was concerned with the limited liability of *shareholders* and not the liability of directors towards third parties, but considered that *Lee*¹⁰⁸ came “closer to that topic”. The principle in *Lee* is challengeable.¹⁰⁹ Further, it is not quite clear how a finding that a company and a *director/employee* are indeed separate would have been helpful to Mr Ivory. Would not separate identity between of a company and a director indicate *separate* liability, unencumbered by considerations of amounts paid up on shares? Would this not indicate a personal duty of care on the part of Mr Ivory therefore? Their Honours do not elaborate on the case of *Lee*.

This is particularly confusing given their Honours’ ensuing discussion of *Tesco*.¹¹⁰ *Tesco* held that a person may be *identified* with a company so as to be its “embodiment or directing mind and will, not merely its servant, representative, agent or delegate”.¹¹¹ Cooke P interpolated from this finding that if a person is identified with a company vis-à-vis third parties, “it is reasonable that *prima facie* the company should be the only party liable”.¹¹² Hardie Boys J also effectively based his reasoning on the finding that the concept of corporate personality means that for some purposes directors and the company are *one*. As Mr Ivory had acted “as” the company in a manner sufficient to render the company liable for the advice, Mr Ivory had therefore *not* also acted as himself.

The case of *Tesco* concerned the attribution of guilt from a natural person to a company. The case recognised that a company itself could not think or act, but could only do so through its directors. In identifying a director with a

¹⁰⁷ *Trevor Ivory* above n 5, 532.

¹⁰⁸ *Lee* above n 38.

¹⁰⁹ See above n 38.

¹¹⁰ *Tesco Supermarkets Ltd v Natras* (1971) 2 All ER 127 (HL).

¹¹¹ *Trevor Ivory* above n 5, 520.

company, it was therefore possible to sheet liability home to the company itself. However, this was not to the exclusion of personal liability on the part of the natural person. It is not clear on what basis the concept of identification is so extrapolated. Hardie Boys J stated that he found no difficulty in the imposition of personal liability on a director in appropriate circumstances; the purpose of incorporation, namely the limited liability of shareholders, “affords no reason” to protect directors from the consequences of their own acts and omissions. However:¹¹³

What does run counter to the purposes and effect of incorporation is a failure to recognise the two capacities in which directors may act; that in appropriate circumstances they are to be identified with the company itself so that their acts are in truth the company’s acts. Indeed, I consider that the nature of corporate personality requires that this identification normally be the basic premise *and that clear evidence be needed to displace it with a finding that a director is acting not as the company but as the company’s agent or servant in a way that renders him personally liable.*

Cooke P put the consequences of this in the following terms:¹¹⁴

It is not to be doubted that, in relation to an obligation to give careful skill and advice, the owner of a one-[person] company may assume personal responsibility...But...something *special* is required to justify putting a case in that class...there is nothing out of the ordinary here.

In other words, their Honours hold that the nature of corporate personality is such that, where a director¹¹⁵ has acted “as” a company in such a way as to render the company liable for the tort of negligent misstatement, the director will be absolved from personal liability unless a plaintiff can show that the director met a significantly-raised threshold of actual or imputed assumption of responsibility.

¹¹² *Trevor Ivory* above n 5, 520 per Hardie Boys J (emphasis added).

¹¹³ *Trevor Ivory* above n 5, 527 (emphasis added).

¹¹⁴ *Trevor Ivory* above n 5, 524 (emphasis added).

¹¹⁵ Or an employee.

The reasons why the threshold must be so much higher than was the case in *Hedley Byrne* are not clearly articulated; however, the explanation must of course stem from the initial emphasis placed on company law. Their Honours seem to hold that where a reconciliation of the two competing common law principles is required in this area, tort law must simply give way to company law.

(c) assumption of responsibility

Having reached a conclusion of effective deference to company law in this context, the Court of Appeal had little difficulty in finding that Mr Ivory had not assumed the prescribed higher standard of personal responsibility on the evidence. Cooke P considered that Mr Ivory's "repeated comments" that he was acting through his company meant that the plaintiffs were not able to *prove* that they had reasonably thought they were dealing with Mr Ivory personally.¹¹⁶ It would not be "reasonable" to say that Mr Ivory had assumed a duty of care as if he were in business on his own account and not through a company:¹¹⁷

...the realistic interpretation is simply that Mr Ivory was identifying himself with his company, as if he had read the *Tesco* case.

It was argued that a one-person company might on its own amount to an assumption of responsibility. Hardie Boys J considered on the contrary that it might rather be seen as a personal disclaimer of such responsibility (although his Honour did acknowledge academic criticism of that view).¹¹⁸

Consequently, despite the fact that a contra preferentim doctrine might place the onus on the person who wanted to claim a privilege such as limited

¹¹⁶ In *Turning Points* above n 28, 18 n 51, Lord Cooke states that the result would probably have been different if they had.

¹¹⁷ *Trevor Ivory* above n 5, 523.

¹¹⁸ *Trevor Ivory* above n 5, 528.

liability, the mere existence of a company¹¹⁹ put the onus on the plaintiffs to “adduce clear evidence that in his dealings with them, Mr Ivory was not simply acting as the company”.¹²⁰ Hardie Boys J found no such evidence although the case did “approach the borderline”. Also, there might have been such an assumption if Mr Ivory had undertaken to do the spraying himself, although with respect, it is difficult to see what difference that would have made.¹²¹

McGechan found that a duty of care on Mr Ivory personally would not be “just and reasonable”, although again the case “approached the line”. The fact that Mr Ivory “retained an insulating corporate structure to guard against the disasters which the spray business can bring”¹²² meant that the plaintiffs “did not perceive Mr Ivory as the contracting or advising party in his own right”.¹²³

(d) the authorities, including *Morton*

The Court of Appeal’s deference to company law is all the more confusing for the manner in which the relevant authorities are handled.

Cooke P acknowledged that the finding of prima facie *sole* company liability, will nevertheless not always hold; there will be circumstances where an officer or servant of a company, even a governing director, may in the course of activities on behalf of the company, come under a personal duty to a third party.¹²⁴ His Honour considered nine cases on this point, seven of which at least *did* find the director to be personally liable.¹²⁵ Why these were not determinative of the case at hand is not precisely clear; his Honour simply

¹¹⁹ *Trevor Ivory* above n 5, 528.

¹²⁰ *Trevor Ivory* above n 5, 528.

¹²¹ See for example the comments in “Developments in New Zealand” above n 75, 104.

¹²² *Trevor Ivory* above n 5, 532.

¹²³ *Trevor Ivory* above n 5, 532.

¹²⁴ *Trevor Ivory* above n 5, 520.

¹²⁵ Joint tortfeasorship is also not discussed, despite, *Trevor Ivory* above n 5, 520, the raising of the case of *Yuille v B & B Fisheries (Leigh) Ltd* (1958) 2 Lloyd’s Rep 596 [Yuille]. In *Yuille*, the company

stated that the English authorities “left the issue fairly open as far as principle is concerned”.¹²⁶

In addition, two New Zealand cases, *Centrepac*¹²⁷ and *Morton*,¹²⁸ directly pointed to personal liability being correctly imposed on Mr Ivory. Cooke acknowledged that *Morton* was “at first sight helpful” to the plaintiffs, however, neither case was either clearly adopted or clearly overruled. His Honour simply stated that it was not necessary to consider *Morton* because it was being distinguished in the judgement of Hardie Boys J.

With respect, however, that was not the case. Hardie Boys J simply stated¹²⁹ that an assumption of responsibility may well arise where a director exercises particular *control* or control over a particular operation or activity:¹³⁰

This is perhaps more likely to arise within a large company where there are clear allocations of responsibility, than in a small one. It arose however in the case of a small company in *Morton*...but not in a case to which I made some reference in my judgement in *Morton*, namely *Callaghan v Robert Ronayne Ltd*.

With respect, this does not distinguish *Morton*. In fact, it raises the question of the significance of the fact that Mr Ivory undoubtedly did exercise “control” in his small company. Again there seems to be an unstated, underlying view that company law simply must have primacy in this area. It will be necessary to return to *Morton* later.

(e) the “elevated harms” of personal and property damage

and the director were found to be joint tortfeasors for the negligent action of sending unseaworthy vessels to sea.

¹²⁶ *Trevor Ivory* above n 5, 522.

¹²⁷ *Centrepac Partnership v Foreign Currency Consultants Ltd* (1989) 4 NZCLC 64,940.

¹²⁸ *Morton v Douglas Homes Ltd* (1984) 2 NZLR 548 (HC).

¹²⁹ *Trevor Ivory* above n 5, 527.

¹³⁰ *Trevor Ivory* above n 5, 527.

Finally, having found Mr Ivory not to be personally liable in this case, Cooke P confusingly articulated three scenarios where the principle in the case will not hold. A director may not avail him- or herself of the *Trevor Ivory* “safe harbour”¹³¹ where the relevant action gave rise to a breach of a fiduciary duty or to one of two “elevated harms”: *personal* injury, and property damage or other economic loss as a result of an *intentional* tort.

The damage in the instant case was physical damage to raspberry vines and consequential financial loss. This “economic loss” had been caused negligently but unintentionally. The significance of this, in his Honour’s view, was that it became:¹³²

...especially important to consider how far the duty asserted would cut across patterns of law evolved over the years in the process of balancing interests...In the instant case it is patent that the object of Mr Ivory in forming a limited liability company, an object encouraged by long-established legislative policy, would be undermined by imposing personal liability.

Whether limited liability for one-person companies is an object encouraged by long-established legislative policy is a matter of debate.¹³³ Nevertheless, his Honour concluded by stating that:¹³⁴

...when he formed his company, Mr Ivory made it plain to all the world that limited liability was intended. Possibly the plaintiffs gave little thought to that in entering into the consultancy contract; but such a limitation is a

¹³¹ I borrow this term from Bob Dugan’s *Business Associations* Lectures, Victoria University of Wellington, 1997.

¹³² *Trevor Ivory* above n 5, 524.

¹³³ The legislation which was considered in *Salomon* was not intended to extend the privilege of limited liability to one-person companies. One person companies were specifically prohibited in New Zealand by the Companies Act 1955. The removal of this prohibition in the Companies Act 1993 might be seen as more of a resignation of the fact that the prohibition was notoriously difficult to circumvent than any direct legislative policy to encourage them. This is particularly the case given how arguably inappropriate for one-person companies the 1993 Act is. This is discussed further below.

¹³⁴ *Trevor Ivory* above n 5, 524.

common fact of business and, in relation to economic loss..., the consequences should...be accepted in the absence of special circumstances.

Again it seems odd that the plaintiffs in the *Ivory* case should receive harsher treatment simply because the destruction of their raspberry orchard amounted to “merely” economic loss.¹³⁵ New Zealand courts would not normally make these distinctions today. It will be necessary to return to this point after a discussion of the judgement in the *Williams* case.

2. *The House of Lords*

(a) the starting point

The House of Lords in *Williams* adopted a different approach in reaching their unanimous finding of no personal liability. In reaching their decision, their Lordships found it unnecessary to embark on a general review of the authorities, stating that the principles governing the case were clearly those enunciated by Lord Goff in *Henderson*.¹³⁶ The “wide” assumption of responsibility principle enunciated in *Hedley Byrne* was not confined to statements but may apply to any assumption of responsibility for the provision of services. This “extended *Hedley Byrne*” principle is the “rationalisation or technique adopted by English law to provide a remedy for the recovery of damages in respect of economic loss caused by the negligent performance of services”.¹³⁷

In other words, their Lordships did not consider that the existence of a company removed the need to perform a standard tort analysis. Their Lordships acknowledged *Trevor Ivory* and the English Court of Appeal’s

¹³⁵ Interestingly, His Honour focuses on the nature of the *damage* and not the fact that the actual wrongful *action* involved words rather than conduct. Traditionally, the law has been readier to impose liability for an act rather than a comment. However, the nature of the relationship is so close in this case that a duty would not have been precluded on a “negligent word” basis alone – the primary concern of allowing liability for negligent words is arguably floodgates which surely would not apply here.

¹³⁶ *Henderson* above n 64.

¹³⁷ *Williams* above n 11, 4.

finding that the general principle in this area must not “set at naught” the protection of limited liability.¹³⁸ However, they considered that the issue in the case was not peculiar to companies.¹³⁹

Whether the principal is a company or a natural person, someone acting on his behalf may incur personal liability in tort as well as imposing vicarious or attributed liability upon his principal.

Their Lordships consequently simply applied a standard negligent-misstatement analysis to the director personally. Essentially, the issue was whether the requirements of *Hedley Byrne* were satisfied. Was there a “special relationship” between the plaintiffs and Mr Mistlin personally such that Mr Mistlin himself could be said to have owed a duty of care?

(b) the importance of the “identification” concept

While Mr Mistlin was argued to play a “pivotal role” in the affairs of the company, the issue of his “identification” with the company did not arise: P, not Mr Mistlin, had acted on behalf of the company.¹⁴⁰

It might be argued, however, that the standard tort approach would have flushed out the fallacy of the identification argument in the course of analysis anyway. It certainly would have prevented the conclusive influence the concept was afforded in two of the *Ivory* judgements. The question at issue was whether Mr Mistlin owed a duty of care; clearly *he* had acted irrespective of whether or not he had also acted as the company. The identification concept is discussed further below.

(c) assumption of responsibility

¹³⁸ *Williams* above n 11, 4.

¹³⁹ *Williams* above n 11, 4.

¹⁴⁰ P is not alleged to have acted “as” the company, from a reading of the House of Lords’ judgement.

As mentioned, the Court of Appeal considered that the impact of company law in this area was such that the threshold for assumption of responsibility should be significantly higher than that predicated by *Hedley Byrne*.

The House of Lords addressed the issue in a different way. For Mr Mistlin to be liable, it was necessary to point to objective evidence of conduct “crossing the line” which conveyed to the plaintiffs that there was an assumption of responsibility by the director such as to create a “special relationship” between the plaintiffs and the director himself. Further, there must be the reliance on that assumption of responsibility by the plaintiffs, objectively determined, in order to establish causation.¹⁴¹ Arguably, this is simply a “classic negligent misstatement tort duty analysis”.

On the facts, as Mr Mistlin had had no personal dealings with the plaintiffs, there was nothing which could have conveyed that he was assuming a personal responsibility to them.¹⁴² Further, there was no evidence that the plaintiffs even believed Mr Mistlin was undertaking a personal responsibility to them.

Criticism of the principle of assumption of responsibility was acknowledged in the case. However, their Lordships considered that there was a gap in the present structure of contract law caused by the principles of consideration and privity. This gap must be filled by tort, and in that role there was, and is, “no better rationalisation for the relevant head of tort liability than assumption of responsibility”.¹⁴³

There was no indication that the threshold for that assumption of responsibility should be higher than in other negligent misstatement contexts. There was no sense in the judgement that company law, and *Salomon*, must simply be deferred to in this context.

¹⁴¹ *Williams* above n 11, 6.

¹⁴² *Williams* above n 11, 7.

¹⁴³ *Williams* above n 11, 7.

(d) the elevated harms

Their Lordships seemed distinctly unconcerned that the loss caused in the *Williams* case was financial, or “pure” economic loss, unconnected with any physical damage. Arguably, they did not need to consider this point as they had already found that a duty of care did not exist. Nevertheless, their Lordships stated that once a case was identified as falling within the “extended Hedley Byrne principle”, there was no need to embark on any further enquiry whether it is “fair, just and reasonable” to impose liability for economic loss.¹⁴⁴ This presents a marked contrast to the judgement of Cooke P in the Court of Appeal.

(e) conclusion

The House of Lords reached their conclusion of no personal liability on the part of the director in a manner that was arguably much more open and much more consistent with authority. There was no unstated deference to *Salomon* to the exclusion of a standard tort analysis. However, the cases of *Williams* and *Ivory* are not altogether inconsistent: Lord Cooke has stated extra-judicially¹⁴⁵ that if the plaintiffs in *Ivory* had been able to *prove* that they had *reasonably* thought they were dealing with Mr Ivory personally, the result in the case would probably have been different. However, the *Trevor Ivory* decision is not expressed in those terms. It is expressed as a rationalisation of two competing common law principles (limited liability versus responsibility for one’s negligence) in favour of limited liability where the wrongful action is negligence and the harm is “merely” property damage with consequent financial loss. The decision would perhaps be easier to accept if it were more

¹⁴⁴ Admittedly, their Lordships cited *Henderson* as authority for this proposition, which was decided three years after the case in *Ivory*. However, Cooke P’s elevation of certain harms is nevertheless confusing as discussed below.

¹⁴⁵ As mentioned above, n 116.

clearly stated as resting on its particular facts (and if the authorities of *Centrepac*, and *Morton* had been more fully addressed).

If the facts of *Trevor Ivory* had fallen for consideration by the House of Lords, it seems feasible that their Lordships have found on those facts that the volume of personal dealings, coupled with the Andersons' seeking of Mr Ivory's services *personally*, would have been sufficient to impose on Mr Ivory a personal duty to take care. To the extent that this seems likely, is it not odd that the House of Lords, given their status in the "commercial centre" of the world, seem to place a much lower premium on the concept of limited liability than does Lord Cooke? Is it not similarly odd that Lord Cooke should place a lower premium on holding Mr Ivory responsible for causing the Andersons' loss, given earlier decisions of his in which he might be viewed, for example, as a champion of a *contra preferentim* doctrine?

This paper considers that a finding of personal liability on the part of Mr Ivory would have been the correct result.

C *Evaluation*

Why did the New Zealand Court of Appeal find that Mr Ivory did not owe a personal duty of care in the circumstances? Cynics might argue along the following lines:¹⁴⁶

...the question [in another case was]...the extent to which the Court was influenced by style rather than content. That takes us to questions about the limits of advocacy, questions also raised by *Trevor Ivory*...where the presence of the defendant [Mr Ivory] at the back of the courtroom in a shabby tweed coat could have focused the minds of the New Zealand Court of Appeal.

¹⁴⁶ David Wishart "From Our Australian Correspondent" [1996] *Company and Securities Law Bulletin* 71, 73 (footnote omitted).

However, a better way of explaining the difference between the *Trevor Ivory* and *Williams* might simply be that different choices were made about the significance of tort law. The New Zealand Court of Appeal simply seemed “bewitched” by the company law case of *Salomon*. Their Lordships simply performed a standard tort duty analysis. Were the Court of Appeal correct in placing such importance on company law?

1. *Company law principles*

The thesis of this paper is that the Court of Appeal were not correct in placing such emphasis on company law, and particularly the case of *Salomon*. If the facts of *Salomon* had come before Lord Cooke himself it seems fair to say he might have decided the case differently utilising a purposive approach. The legislature of Mr Salomon’s time never intended one-person companies to have the privilege of limited liability. The contribution to society of large railway-building companies cannot simply be extrapolated to one-person companies. Whether limited liability for one-person companies is appropriately needs to be separately justified. Large companies and one-person companies are different “things”. Arguments in respect of one do not necessarily apply equally to the other.

Further, the case of *Salomon* limited personal shareholder liability with respect to unsecured *trade* creditors of the company. The case is not authority for the principle that a *director* should be absolved from liability for *negligence*. Tort debts were never considered in the case of *Salomon*. The foundation cases of *Donoghue v Stevenson*¹⁴⁷ and *Hedley Byrne* were decided many years after *Salomon* and the debate about concurrent liability in contract and tort was only recently settled in *Henderson*.

¹⁴⁷ *Donoghue v Stevenson* [1932] AC 562 (HL).

Salomon is no authority for the proposition that a director's liability should be limited. If a director happens also to be a shareholder that does not alter the fact that the person acted as a director, not as a shareholder. It is not appropriate to extend to directors the principles of separate identity and limited liability, which were never intended to apply to one-person companies, simply because in a one-person company they happen to be the same person (by definition). On the contrary, this factor arguably underlines the difficulty with, and the inappropriateness of, the availability of the privilege of limited liability for one-person companies. They are a historical accident and an inappropriate use of the corporate form. They certainly should not be used as a basis for extending the already-significant privilege of limited liability for trade debts.

One commentator has put it as follows:¹⁴⁸

At the outset it is worth observing that the policy of having limited liability for corporate torts seems not to have ever been subjected to any significant degree of legislative or judicial scrutiny. When the principle was first introduced in 1855, the preceding debate had been about limited liability and voluntary creditors. Similarly, in the *Salomon* case in 1897 which affirmed the choice made by the legislature to have limited liability, there was considerable discussion of the wisdom and fairness of the policy as applied to trade and financial creditors but no mention of tort creditors. *The courts seem to have drifted towards the assumption that limited liability applied also to torts.* It is not difficult to see why the special challenges posed by tort creditors were not also carefully considered; at that time tortious remedies were relatively undeveloped. *Salomon* was decided 35 years before *Donoghue v Stevenson*. Even in developed law it is difficult to find examples of situations where companies have been put into insolvent liquidation as a result of a tort claim. Probably companies usually have sufficient assets to meet tort claims either from their own assets or from insurance. Nevertheless, the lack of examples may be deceptive because if a company is on the edge of insolvency a tort claimant might not go to the bother and expense of suing it

The commentator continues by saying:¹⁴⁹

The tort victim is not in a position to contract for a compensating benefit or to avoid or monitor the risk to which the company is exposing him. On this kind of basis, many...scholars...have concluded that the basic theoretical arguments do not adequately support the policy of having limited liability for tortious debts...They emphasise that in certain circumstances limited liability encourages overinvestment in hazardous industries, for since costs are externalised a corporation engaged in highly risky activities can be an attractive investment for its shareholder and yet its net value to society as a whole is negative; to put it simply, the company's tort victim's are subsidising it.

Fundamental adherence to *Salomon* on the facts of *Ivory* is highly challengeable. However, this paper considers that the fundamental adherence to *Salomon* is not the only difficulty with *Ivory* case. The decision is also challengeable on several other grounds.

2. *Duty analysis*

The starting point¹⁵⁰ in any case in New Zealand where the existence of a duty of care is disputed is considered to be *South Pacific*,¹⁵¹ which was decided by the Court of Appeal only a few months' prior to the decision in *Ivory*. Their Honours make only passing references to the decision in *Ivory* and base the decision on an assumption that, in this context, company law is more important.

However, that assumption is clearly challengeable. Further, the tort analysis prescribed in *South Pacific* specifically incorporates a list of factors in determining whether a duty exists. The Court of Appeal specifically

¹⁴⁸ Pettet, 152 (footnotes omitted).

¹⁴⁹ Pettet above n 13, 153 (footnotes omitted).

¹⁵⁰ Todd above n 7, vii.

considered that whether an incremental approach or an *Anns*¹⁵² two-stage approach is adopted for determining whether a duty of care exists makes no fundamental difference so long as all the considerations are weighed. If company law really did have primacy on the facts of a particular case, the standard tort analysis would arguably “flush that out” in its consideration of all the factors at issue.

How might the *Ivory* case have been decided had a *South Pacific* approach been taken? The issue in *South Pacific* was whether an investigator, under contract with an insurance company, owed a duty to take care in statement to the insured plaintiff when reporting on the cause of a fire. In other words, it presented a similar tripartite structure to the *Ivory* fact situation. Factors which the Court of Appeal addressed in determining the existence or otherwise of the duty of care included the following.

- (a) the degree of proximity between the parties

The relationship between the Andersons and the company, Trevor Ivory Ltd was sufficiently close and direct to warrant imposing a duty of care, partly illustrated by the contract between them. Does this contract preclude the existence of a duty of care between the Andersons and Mr Ivory himself? Proximity is a difficult concept. In *Henderson*, it was held that the mere existence of a contract did not preclude liability in tort. In *South Pacific*, it was held that the existence of a contract between two of the parties did not preclude a duty of care owed by the third party to the plaintiffs. Richardson J held¹⁵³ in that case that where a contract covered a relationship, that contract should ordinarily cover the allocation of risk unless special reasons are established to warrant a duty of care in tort. Their Lordships in *Henderson* on the other hand, considered that tort law was the general law out of which the

¹⁵¹ *South Pacific* above n 51.

¹⁵² *Anns v Merton London Borough Council* [1978] AC 728 (HL).

¹⁵³ *South Pacific* above n 51, 308 per Richardson J.

parties could contract: "Courts should not impose tort obligations inconsistent with the contractual agreement between the parties as parties always remained free to exclude tort".¹⁵⁴

An issue arises of what effect the contract between the Andersons and the company should have on the existence or otherwise of a tort duty on the part of Mr Ivory personally. The argument that the imposition of a personal duty amounts to the "use of tort to supplement a contractual bargain" does not hold when the bargain the parties really made is considered. It will be necessary to return to this point. However, that factor aside, it seems clear that the relationship between the Andersons and Mr Ivory was sufficiently proximate to warrant a duty of care. The Andersons looked to Mr Ivory personally in the context of a long-term consultancy relationship. Advice businesses are personal by definition. Proximity would indicate a personal duty of care.

Further, the fact of this proximity would mitigate any floodgates concerns. It is clearly defined who the victims might be.

(b) the plaintiff's moral claim to compensation for avoidable harm

An advantage of a more traditional tort analysis is that it allows a more thorough balancing of the competing interests at stake. Arguably, the Court of Appeal in *Ivory* subordinated the plaintiffs' moral claim to compensation for avoidable harm¹⁵⁵ to a deference to the *Salomon* case. The tort analysis allows a more specific consideration of the merits of such a claim. It was held in *South Pacific* that such a claim increases where there are no obvious means by which plaintiffs may have protected themselves from the risk of carelessness on the defendant's part.¹⁵⁶ Mr Ivory had the knowledge of the potential havoc his sprays could wreak. There was no reason to suppose the Andersons had the

¹⁵⁴ *Henderson v Merritt Syndicates Ltd* [1995] 2 AC 145.

¹⁵⁵ *South Pacific* above n 51, 306.

¹⁵⁶ *South Pacific* above n 51, 307.

same knowledge given the extent to which they were willing to pay Mr Ivory for the knowledge that was at his disposal. Mr Ivory was in a better position to monitor the consequences of his negligence. All he has to do was take reasonable care. The Andersons' business was no doubt as important to them as Mr Ivory's was to him. It is difficult to see what the plaintiffs in the case could have done to protect themselves. It seems reasonable that they should have carried out Mr Ivory's advice to the letter. Whether they should have contracted more specifically on the issue of liability is arguably not a diminishing factor because on an evaluation of *moral* claims, Mr Ivory should *morally* have brought this issue, and the risks, more fully to their attention. The plaintiffs in the *Ivory* case arguably have a strong moral claim to compensation.

Importantly, any extent to which there was room for criticism of the Andersons could be taken into account in the award of damages rather than denying the existence of a duty of care altogether.

Against this should be balanced the defendant's moral claim to be protected from an undue burden of legal responsibility.¹⁵⁷ For example, would the duty expose the defendant to a burden out of proportion to his moral culpability?¹⁵⁸ A duty to take reasonable care imposed on Mr Ivory would be no more onerous than the equivalent duty that is placed on every other citizen. Business can be conducted perfectly acceptably without negligence. Arguably, the imposition of liability here would create incentives to take care and thereby assist in the maintenance of professional standards generally. Given the dubious applicability of *Salomon* to one-person companies and to tort creditors generally, it is difficult to see that imposing personal liability here would be *out of proportion* to Mr Ivory's moral culpability. This factor weighs in the Andersons' favour.

¹⁵⁷ *South Pacific* above n 51, 306.

¹⁵⁸ *South Pacific* above n 51, 307.

(c) the integrity of other legal principles

Under this head, the significance of the existence of the corporate form could be specifically considered. Whether the availability of limited liability for one-person companies, and for tort creditors of companies generally, is indeed appropriate could be addressed fully. This must be preferable to an underlying, arguably unevaluated assumption that *Salomon* must be upheld, almost at all costs. This analysis could make apparent that a finding of liability on the facts of *Trevor Ivory* would not undermine the value of the corporate form. The legion of other instances in which the corporate veil has been lifted might be examples of that. A finding of liability would arguably move the corporate form closer to how it was originally intended to operate, and closer to what the privilege of limited liability was originally granted in order to achieve. It was certainly never intended to act as an incentive for directors not to take care. A finding of liability on the part of Mr Ivory would arguably bring a more appropriate and defensible balance between the competing interests and businesses at stake.

(d) the harm itself

Some analysis of whether the harm caused was economic loss is appropriate under this heading, however, this point is considered later.

The degree and magnitude of the risk of harm are also appropriately considered under this head. These factors must favour the existence of a duty given the intrinsically risky nature of the spray business, and the extent to which negligent application of or advice to apply spray could foreseeably (and did) cause harm to the plaintiffs.

(e) the impact of any relevant statutes

The analogy of a statute may “properly influence the development of the common law”, for example by encouraging the court to hold that certain interests warrant protection.¹⁵⁹ It is significant that the Companies Act 1993 has specifically increased the exposure of directors to personal liability¹⁶⁰ reflecting a clear policy initiative to hold directors more accountable for their actions. The Fair Trading Act 1986 and the Consumer Guarantees Act 1993 reflect a similar policy of the importance of the maintenance of standards in business contexts. These factors would indicate a duty.

(f) any assumption of responsibility

The question of whether the defendant assumed any responsibility towards the plaintiff would be appropriately considered in its original form, that is to the significantly lower threshold originally postulated by *Hedley Byrne* (even as modified by *Henderson*). There would be no apparent need to raise the threshold of the test in deference to the corporate form as the existence of the company would be separately considered. Importantly, the tort analysis emphasises that the existence of the company is only one factor out of a range of factors which must be considered in the duty analysis.

The personal nature of the relationship, and the fact that the Andersons were reasonably looking to Mr Ivory personally, on the facts, clearly indicates a personal assumption of responsibility in this case when the original threshold is applied.

In addition, the imbalance of knowledge in the *Ivory* case, the corresponding reliance and dependence of the plaintiffs on the advice of Mr Ivory and Mr Ivory’s awareness of those factors also indicate a duty. When a person seeks an advisor’s advice they are suspending their own responsibility. That’s the point. This is underlined by analogy with the solicitor and debenture holder

¹⁵⁹ *South Pacific* above n 51, 298 per Cooke P.

¹⁶⁰ See for example s135 Companies Act 1993, discussed further below.

cases mentioned in *South Pacific* and the “high degree of likelihood that careless performance of that responsibility will cause harm to the plaintiff.”¹⁶¹

However, a further issue arises as to whether, on a *Hedley Byrne* analysis, the company might be viewed as a “reasonable disclaimer” of liability.¹⁶² This issue is almost the corollary of the assumption of responsibility question; assumption of responsibility and disclaimer of liability appear to be almost two sides of the same coin. Clearly, the disclaimer issue must be addressed on the facts, as it was in *Hedley Byrne*; the mere existence of a company indicates nothing on its own outside of an analysis of the context in which it was perceived and treated by the parties.

Again, on the facts, the company cannot have been a *reasonable* disclaimer of liability in this case; neither party had thought about what was the perception of the other with respect to liability. A *reasonable* disclaimer must surely be clearer than that. It would also be appropriate to consider contra preferentim principles. Arguably, a party seeking the privilege of limited liability should bear the onus of proving that limited liability was the genuinely-contracted bargain.

Even if it were considered that, on the facts, the company did weigh towards a duty of care, again this would be only one factor to be weighed in the ultimate balancing exercise. The fact that it was at best a very weak and unclear disclaimer of liability, as evidenced by the fact that it had clearly not disclaimed liability in the minds of the Andersons, would be necessarily taken into account.

(g) the availability of other remedies

¹⁶¹ *South Pacific* above n 51, 308.

¹⁶² See Todd above n 7, 528 for a criticism of the Court of Appeal’s judgement on this point: “does the company amount to a sufficient disclaimer of liability or not?”

Having reached a finding that the Andersons were morally entitled to compensation for their loss, the tort analysis specifically allows consideration of the fact that there were no other effective remedies available to the Andersons. The company would have had no money to meet the claims against it.

Richardson J found no duty on this point in *South Pacific* because any inadequacy of an insurance remedy would simply have been because the plaintiffs had “only paid a premium which gave them that lesser protection.” His Honour considered that contractual remedies were an appropriate sanction against want of care in that case and he could not see any justification for allowing a “greater recovery in tort than [the plaintiffs] were prepared to pay for in contract”.¹⁶³ However, in the *Ivory* case, the existence of the company had a distortionary effect on the allocation of risk, inhibiting that risk from being appropriately taken into account. The Andersons were not seeking to supplement their contractual bargain by bringing the tort action, but were instead simply seeking to enforce the bargain they reasonably thought they had. Arguably, the risk was not factored into the fee due to the distortionary effect of Mr Ivory’s company, the lack of awareness of the significance of that on the part of the plaintiffs’ and the lack of any incentive on Mr Ivory’s part to draw that significance to their attention. Contractual remedies would not be an effective sanction at all in *Ivory*. A personal duty on the part of Mr Ivory is further indicated.

(h) general economic considerations

Also pointing towards a duty are general economic considerations, generally summarised by asking “which is the best party to bear this loss”? It has been argued that the Andersons are better placed to bear the loss because they are better placed to obtain insurance for their crop. They know how much the crop is worth and can therefore obtain insurance of an appropriate value. Mr Ivory,

it is argued, is unlikely to be able to obtain insurance so the loss is more appropriately borne by the victims of his negligence. If he were able to obtain insurance, a situation of double insurance should be avoided as this would be "inefficient".

However, is it correct to say that the Andersons could insure against this loss? Mr Ivory's negligent advice might be seen by an insurance company as foreseeable and falling outside the standard category, for insurance in this area, of "fortuitous, unforeseen consequence". The Andersons might not be able to obtain insurance for this particular type of loss. Mr Ivory on the other hand has the possibility of obtaining professional indemnity cover, (and then factoring the cost of this into his fee). Arguably, Mr Ivory is in the best position to monitor his tort risk; Mr Ivory has the knowledge-advantage of knowing what the sprays are capable of, and the risk that they entail. The Andersons paid for Mr Ivory's advice precisely because they did not have this knowledge. Spraying is not always of noxious substances. Fertilisers and acidity regulators such as calcium and lime are common sprays; spraying may occur several times daily over many years and many orchards without incident. The Andersons surely cannot be taken to have reasonably suspected that their entire orchard was at stake when they asked for Mr Ivory's spray advice.

The cost of the insurance premium to Mr Ivory will depend on factors such as experience and previous claims. If insurance turns out to be prohibitively expensive for Mr Ivory that is a clear market indication that the business should not be undertaken. Alternatively, it would force him to specifically contract on the issue of liability in each case. Undoubtedly, the Andersons would not have gone ahead on the same terms if they were fully aware of the risk. There is an issue of informed consent in this context: the person who has the knowledge should have an onus to communicate that knowledge to enable a fully-informed decision by the potential victim. If people in Mr Ivory's position have automatic limited liability removed, cannot get insurance, and

¹⁶³ *South Pacific* above n 51, 308.

cannot get clients to voluntarily and expressly agree to accept the risk of the loss, they always have the further option of simply taking more care in the first place. Arguably, a legal regime which encourages this would be more efficient.

A micro level economic analysis arguably indicates the existence of a duty. (It will be necessary to attempt later a more macro-level economic analysis concerning the justification for the existence of limited liability generally).

Ultimately, the question in *South Pacific* is whether a duty is “just and reasonable” in all the circumstances.¹⁶⁴ From the preceding analysis it seems clear that that should have been the case. The fact that a *South Pacific* approach to the case was not undertaken has been criticised. One commentator put the situation as follows:¹⁶⁵

The court appears to have held that there is a presumption that by choosing to make a contract with a limited liability company the plaintiff accepts that any personal liability on the part of the director...is excluded: Cooke P spoke of the need for “special circumstances” to justify personal liability....Thus it is up to the plaintiff to establish that personal liability was intended, not for the defendant to establish that it was not. This approach is hard to reconcile with normal principles of negligence liability...one should start with the liable human and move from there to the liable company, not vice versa.

In this respect the approach of the Court of Appeal can be seen as a significant departure from authority, which departure can arguably only be explained by a questionable deference to the principle of *Salomon*.

3. Identification

¹⁶⁴ *South Pacific* above n 51, 306 per Richardson J.

¹⁶⁵ Todd above n 7, 372.

As a matter of theory, the doctrine of identification is proposed in *Trevor Ivory* as a justification for the virtual presumption that a director does not assume personal liability.¹⁶⁶

However, it not clear why identification should create a “magic cloak” that renders a human agent “invisible” or non-existent. How can a human agent *cease* to act as him or herself while acting “as” the company. Surely one and one should make *two*?

The invocation of the principle of identification in the *Trevor Ivory* case has been described as being “demonstrably in error”¹⁶⁷ and a misapplication of the case of *Tesco*:¹⁶⁸

...the use of the doctrine of identification is one point at which the reasoning of the Court of Appeal is not reliable. The doctrine of identification is a fiction for establishing the state of mind of a company. It is far-fetched to imagine that it is a consideration in the assumption by a director of personal responsibility.

The recent Privy Council case of *Meridian*¹⁶⁹ displaces the doctrine of identification with principles of “attribution”, a concept which more clearly encapsulates the essence of *Tesco*. The essence of the difference between the two concepts might be described as follows. Basically, identification makes the company and the director “one” in order to determine whether liability can be sheeted home to a company at all. However, it does not make them “one” in the sense that it precludes or somehow erases the separate liability of the human agent for what will effectively be the same act. Attribution encapsulates this better, because it more clearly extracts just what is necessary

¹⁶⁶ “Developments in New Zealand” above n 75, 105.

¹⁶⁷ PG Watts “Company Law” [1995] Recent LR 237, 237.

¹⁶⁸ “Developments in New Zealand” above n 75, 106 (footnote omitted).

¹⁶⁹ *Meridian Global Funds Management Asia Ltd v The Securities Commission* (1995) 3 WLR 413 (PC) [*Meridian*].

from the already-tortious act of the human agent in order to determine if the company is additionally liable.

It has been suggested that the rejection of the identification doctrine in *Meridian* renders untenable the principle that a director is identifiable "as" the company and therefore not liable for tortious acts unless the director assumes personal responsibility. In other words, in any future consideration of a *Trevor Ivory* fact situation:¹⁷⁰

...it will not be possible for the courts to say that a director is identified with the company...and therefore...cannot be liable to a third party. Instead, the liability of the company should be considered discreetly [sic] from the liability of the director. In determining the liability of the company...the Court would easily decide...that *for that purpose*, the act of Trevor Ivory was the act of the company. But it would not follow that Trevor Ivory was identified with the company to the extent that clear evidence would be needed to displace that notion....Instead his liability would be determined as a separate issue.

This is precisely the result indicated from a traditional tort analysis. The issue in *Ivory* should have been whether the director's own acts satisfied the requirements of a legal wrong.¹⁷¹ Built as it is upon the foundations of *Tesco*, "the reasoning in *Trevor Ivory* can be no longer considered as the means for determining the tortious liability of a director to a third party".¹⁷²

4. The "elevated harms" of personal and property damage

¹⁷⁰ Susan Watson "Anthropomorphism Reined In?: The Effects of the *Meridian* Decision on the Tortious Liability of Directors to Third Parties" [1997] *Company and Securities Law Bulletin* 149, 154 ["Anthropomorphism"].

¹⁷¹ Neil Campbell "Directors' Liability to Third Parties" [1998] *Company and Securities Law Bulletin* 34, 35.

¹⁷² "Anthropomorphism" above n 170, 154. However, for a contrasting view, see Grantham above n 50, 261 who considers that attribution would work in the same way as the Court of Appeal considered identification did in *Ivory*.

Another difficulty with the reasoning of the Court of Appeal in *Ivory* is the significance given to the type of harm that was caused. The damage in the *Ivory* case, property damage with consequent financial loss, had been negligently caused and therefore fell outside the articulated “safe harbour”: personal injury or *intentionally*-caused property damage. That these two harms are “elevated” is confusing for two broad reasons.

Firstly, why was pure economic loss that was nevertheless *intentionally* caused not similarly elevated? Commonwealth jurisprudence contains many examples of cases where courts have considered it appropriate to “pierce the veil” and find personal liability on the part of a director where, for example, fraud or conversion was involved. Cooke P himself has mentioned, extra-judicially, that the only broad class of veil-piercing cases which is truly consistent with the *Salomon* reasoning are cases where:¹⁷³

...under enactments such as those against fraudulent or wrongful trading, or on the permissible interpretation of an enactment of contract, or for the purposes of common law or equitable principles against fraud or oppression or relating to agency, it is necessary to look at what happened in fact rather than in form.

Of course, torts such as fraud or conversion generally cause monetary losses, or damage of a “pure economic loss” character. To have included these would have highlighted the incongruity of the exclusion of the harm caused in the *Ivory* case. Nevertheless, they should not have been excluded from the analysis.

Secondly, the exclusion of the damage caused in the *Ivory* case is curious itself.

I assume that the basis for elevating the harms of personal injury and intentionally-caused physical damage in *Ivory* stems from the historical

development of the common law of tort. A primary concern of that law has traditionally been the safeguarding of bodily integrity,¹⁷⁴ with the safeguarding of property coming a close second. In articulating that the “kind of harm” is a factor to be taken into account in determining the existence of a duty, Cooke P in *South Pacific* separated out personal injury on the grounds that “the first concern of the law is naturally personal safety. Or at least most people would, I think, say so”.¹⁷⁵ All other damage, including physical damage to property or financial loss, however, was characterised as “economic loss”.¹⁷⁶

Negligence cases involving financial loss have traditionally been controversial due to floodgates concerns. However, financial loss which is consequent on damage to land or property is generally “recoverable without especial difficulty”.¹⁷⁷ What real difference is there for example between personal injury negligently caused and property damage negligently caused (bearing in mind the effect on personal injury claims in New Zealand of the Accident Compensation legislation)? New Zealand courts would not normally relegate the damage caused in *Ivory*. What difference does it really make? The property damage and consequent financial loss in *Ivory* occurred as a result of a tort that fell short of intention, but on any analysis must have been devastating to the Andersons. Small, agricultural businesses such as the Andersons’ are important to the New Zealand economy. Protection of them for both the people involved and for the economy as a whole should not be subordinated to traditional categorisations without examination. Society develops, and we may have reached a point where the traditional elevations are less justifiable today than they were during their heyday in the 19th century.

¹⁷³ *Turning Points* above n 28, 13.

¹⁷⁴ Todd, above n 7, 9. I use “bodily integrity” for the purpose of discussion, aware that civil actions for personal injury by accident are now generally barred in New Zealand by the Accident Rehabilitation and Compensation Insurance Act 1992.

¹⁷⁵ *South Pacific* above n 51, 296.

¹⁷⁶ *South Pacific* above n 51, 296.

¹⁷⁷ Todd above n 7, 11.

One commentator has put it as follows:¹⁷⁸

It might be argued...that direct personal responsibility is more acceptable where the director has indulged in conduct that amounts to a tort such as fraud or conversion (with its clear indications of deliberate wrongdoing by the director...) but is less acceptable where what might be described as "mere" negligence is involved. In the latter instance, the conduct of the director, wrongful though it is, is possibly less reprehensible and less deserving of leading to his personal liability for what was the wrongdoing of the company. I fail to see why the modern law of torts should make any distinction between what might be called degrees of wrongdoing. That might be reasonable were criminal liability in question. I do not see that it is where compensation, not punishment, is the issue.

Arguably, the non-articulation of the precise reasons for elevating only these harms undermines the integrity of other reasoning in the judgement. For example, if the object of incorporation would be undermined by imposing personal liability in the *Trevor Ivory* situation,¹⁷⁹ why would that not also be the case when one of the elevated harms arises? Another commentator has stated that:¹⁸⁰

To decide that there are *any* circumstances in which shareholders can be held liable for tort damages even though the formalities of the corporate form have been observed is to discard limited liability in principle...as soon as one has recognised that shareholders can be personally liable for corporate torts in principle, one is logically driven to employ general principles of tort law...to determine the scope of their potential liability.

The judgement of the Court of Appeal in *Ivory* was influenced by the fundamental importance their Honours placed on company law. It seems fair to say that Cooke P resiled from that strict position slightly, perhaps in the interests of justice, by articulating the elevated harms: in circumstances where

¹⁷⁸ Fridman above n 7, 57.

¹⁷⁹ *Trevor Ivory* above n 5, 524, line 27.

¹⁸⁰ Hansmaan above n 12, 1932.

these types of harm are caused, company law should *not* take the same primacy. However, if that initial standpoint had not been taken, and a traditional tort analysis had been undertaken instead, this would not have been necessary, and the arguable confusion caused by the elevation of certain harms only would not have been created.

5. *Morton v Douglas Homes*

In the case of *Morton*, a building company wanted to build a block of flats on top of an old shingle pit which had been covered with sawdust and spoil. The Council required the company to report on the flats' proposed foundations. The company instructed an engineer to prepare the necessary report but failed to implement its stipulated requirements. The company also laid heavy concrete structures on the ground against the report's advice. Many of the ultimate purchasers of the flats were elderly; when the flats suffered damage due to the subsidence of the foundations, they sued for the cost of repairs and for diminution in value of their properties. The company *and the directors personally* were held liable in negligence for having caused this economic loss.

The Court of Appeal's decision in *Ivory* is also confusing because of the handling of the case of *Morton*. Why were the directors personally liable in *Morton* but not in *Ivory*? If *Morton* was wrongly decided, why did the Court of Appeal not explicitly overrule it?

The negligence in the *Morton* case concerned *omissions* (negligently failing to ensure the engineer's recommendations were carried out). The negligence in *Ivory* concerned a *statement*. However, negligence for both types of "act" is sufficiently well-established that the distinction between the cases cannot be founded on this basis.

Cooke P stated that on the particular facts there was an assumption of responsibility in *Morton* but not in *Ivory*.¹⁸¹ Why is this the case when the directors in *Morton* also acted through a company?

The company in *Morton* was perhaps less “one-person” than Mr Ivory’s company; it employed a staff-member (Mr McMillan) and had all its construction work carried out by gangs of labour-only builders,¹⁸² causing it perhaps to have more substance independently of the directors themselves. However, arguably this would have presented less of a case for personal liability. In addition, there was a significant lack of personal dealings with the plaintiffs in comparison with the *Ivory* case. If there was an “assumption of responsibility” in *Morton* there certainly should have also been one in *Ivory*.

Can the rationalisation be that there is a “building exception” in the area of personal director liability in New Zealand? Cooke P does not indicate so in his judgement:¹⁸³

Clearly the judgement [in *Morton*] was *not* intended to lay down a general rule in building negligence cases and it would be unsafe to try to argue from one particular set of facts to another.

However, one commentator has argued that this must nevertheless be the case.¹⁸⁴

The decision [in *Morton*] can be justified, if at all, on the grounds that under New Zealand law there is an obligation imposed on every person concerned with the construction of a house to ensure that the house is properly constructed, which is not based on an assumption of responsibility... This would be an odd duty, which does not attach to other goods or products: but there is considerable judicial support for its existence, and it enables us to make sense of *Morton*.

¹⁸¹ *Trevor Ivory* above n 5, 523

¹⁸² *Morton* above n 128, 555.

¹⁸³ *Trevor Ivory* above n 5, 523.

¹⁸⁴ “Corporate Personality” above n 29, 37.

Arguably this would be in line with New Zealand's statutory context which (now) includes the clear consumer protection focus of the Consumer Guarantees Act and the Fair Trading Act. It might simply be the case that, in policy terms, homeowners in New Zealand should be protected from the consequences of negligent builders. This would reflect the importance to the New Zealand psyche of owning one's own home and the fact that purchasers of homes cannot be expected to have inspected the builders' work.¹⁸⁵ It also might reflect a reality of the building industry in New Zealand whereby it has been common for builders to conduct trade through complicated corporate structures in order to shield themselves from personal liability. A finding of personal director liability might reflect society's disapprobation of such conduct.¹⁸⁶

If it was reasonable to differentiate on this basis, however, why did the Court of Appeal not say so? It might have been arguable that any such "building exception" protects consumers, not business-people and arguably the Andersons were not "consumers" in the sense intended by the legislation. Further, the Andersons might have been argued to have been in a better position to protect themselves against the consequences of Mr Ivory's negligence than were the house-purchasers in *Morton*.

However, this position might be controvertible. One could argue that the Andersons were not in a position that was so markedly different from a house purchaser. They were at a knowledge disadvantage and a position of reliance,

¹⁸⁵ For other arguments in favour of a building exception, see Sir Robin Cooke "An Impossible Distinction" (1991) 107 Law Quarterly Review 46, 62-67.

¹⁸⁶ Indeed Lord Cooke notes, in *Turning Points* above n 28, 12 that the "avoidance or evasion...of local taxation regimes or legislative controls must be indeed among the primary reasons for the international proliferation of companies". The plaintiffs in *Ivory* argued that Mr Ivory's company was purely a "tax device". In 1985, when the negligent act actually occurred in that case, the top personal tax rate was 66%, compared with a company tax rate of 45%. The use of companies to split income and thereby reduce tax was widespread. It is also questionable whether the law should permit the privilege of the limited liability company to be used in such ways.

and there does not seem to be such a difference between a consumer and a small business person that such a difference in result is warranted. Arguably, the New Zealand psyche values small businesses in a similar manner to the way it values homes; if there should be a special rule to protect homes, therefore, it would be arguably appropriately applicable to small businesses also. The Andersons' small business must certainly have been as important to them as was their home, and possibly even a larger investment. All the reasons for allowing a building exception might apply to a small business exception as well.

In fact there may even be a stronger argument if the Andersons are really considered not to be "consumers". Consumers harmed by a company's negligent misstatement receive protection under the Consumer Guarantees Act. If people in the position of the Andersons are to be denied both legislative protection, because they are not consumers, and also protection under tort law, there is arguably a gap in the law that is contrary to the general legislative scheme. This would arguably indicate that a small business exception is appropriate as well.

On the other hand, a small-business exception might be argued to be less defensible because it would affect a smaller class of people. However, it would still affect a significant class, given the amount of small business that is conducted in New Zealand.

The difficulty with the *Ivory* case is that if it was reasonable to differentiate between the cases on the basis of a "building exception", why did their Honours not say so? Why did their Honours not simply say that New Zealand law acknowledges these other duties with respect to homes that it does not acknowledge with respect to small businesses? Their Honours seemed concerned not to overrule the *Morton* decision. However, its direct inconsistency with the *Ivory* decision constitutes a further difficulty with the *Ivory* case.

V WHAT SHOULD THE LAW BE IN THIS AREA?

The decision in *Ivory* arguably creates the wrong incentives. It amounts to an immunity from the requirement to take reasonable care.¹⁸⁷ The Court of Appeal were concerned that commercial enterprise and endeavour should not be discouraged by subjecting directors to such “onerous potential liabilities”. However, why would that be the case if liability were imposed in *Ivory*? Aside from the difficulties with the application of this argument to one-person companies generally, limited liability might be argued to be an incentive to assume too much risk¹⁸⁸ Entrepreneurial activity can flourish quite adequately without limited liability.¹⁸⁹ If limited liability is desirable, then parties will contract for it specifically (as they did before 1855). If no creditor will conduct business in a particular case on those terms, then the argument that the mere existence of a company has made it “clear” that limited liability for negligence was impliedly contracted for, breaks down. Why should the mere existence of a company remove the requirement for a person to take reasonable care? All Mr Ivory had to do was take *reasonable* care. How “onerous” can that be, especially when the consequences for the Andersons are weighed in the equation? How desirable is a legal rule which encourages company directors as a class not to take reasonable care – to “overinvest in risky activities and underinvest in safety”?¹⁹⁰ The law should encourage the desire to create proper investment and safety incentives.¹⁹¹ Limited liability is a privilege. We should not allow the interposition of a company, an admitted metaphor, to prevent a judgement that is otherwise required.¹⁹²

¹⁸⁷ One could ask, if it had been Mr Ivory's own farm, would he have made the same mistake?

¹⁸⁸ Hansmaan above n 12, 1894, 1904-6.

¹⁸⁹ Hansmaan above n 12, 1924.

¹⁹⁰ See Hansmaan above n 12 generally.

¹⁹¹ Leebron above n 16, 1581.

¹⁹² Nicholas James “Separate Legal Personality; Legal Reality and Metaphor” (1993) 5 Bond Law Review 217, 223.

It therefore seems valid to ask what, from a policy perspective, would we want the law in New Zealand in this area to be?

It has been argued that irrespective of the merits of the decision in *Ivory*, the decision should stand because at least it is "certain". The utility of a statutory framework is measured in part by the "certainty which it brings to the calculation of transaction costs".¹⁹³ Once certainty is achieved, people will organise their affairs and the invisible hand of the market will lead to a final state of affairs that is "fair".

However, the *Ivory* decision has not been certain in application: some judges have applied the decision and others have made every effort to distinguish it,¹⁹⁴ thereby precluding certainty for a litigant. Exactly when a director will be held to have crossed the line and made a tort his or her own is unclear,¹⁹⁵ and some have argued that to find the director liable in *Fairline* and not in *Ivory* attributes a degree of legal sophistication to the parties which does not reflect commercial reality.

Reform is therefore indicated. In fact, it seems odd that reform has not been called for earlier. The answer to this, however, must be that there is no organised body to argue for the reform. The largest contract creditors by class, banks, generally protect themselves through the use of personal director guarantees, thereby achieving effective unlimited liability in a limited liability regime. Directors of course as a class prefer the status quo; limited liability arguably gives them "something for nothing". Why would they therefore argue for its abolition. Victims, particularly tort victims, are not organised as a class.

¹⁹³ Pollard "Fear and Loathing in the Boardroom: Directors Confront New Insolvent Trading Provisions" (1994) 22 ABLR 392, 396 cited in Thomas Telfer "Insolvency: Inroads into Corporate Personality in the Insolvency Context - Commentary" in *Conference Papers - "A Centenary Celebration of Salomon" Conference* [1997], 17.

¹⁹⁴ "Anthropomorphism" above n 170, 152.

¹⁹⁵ Pettet above n 13, 137 n 67.

Nevertheless, reform is necessary. Some commentators have argued that the principle in *Salomon* is often “unthinkingly applied”, a practice which creates “unexamined and unexpected consequences made meaningful only by reference to the original metaphor”.¹⁹⁶ They argue that, instead, in every situation in which the separate legal entity concept is to be applied, one must “go back to basics” and ask what are the underlying economic purposes of limited liability, and to what extent do they require the doctrine to be applied here?¹⁹⁷ The concept of a company as a separate legal person, a metaphor of limited use like all legal fictions, can only be justified by and assessed to the extent that it services the law’s social and economic ends.¹⁹⁸ It is essential that the interests of decision makers are brought more closely into line with societal interests in this area.

There are two possible avenues of reform: one could reform the law of companies, or one could reform the law of tort.¹⁹⁹ Each is considered in turn.

VI REFORM

A Reform Company Law

1. The “essential company concept”

A discussion of company law reform might begin with what might be termed the “essential company concept”. It can be seen that the original introduction of general limited liability was geared towards a certain type of company: it was one in which a large aggregation of wealth was necessary in order to

¹⁹⁶ James, Bond LR, 227.

¹⁹⁷ James, Bond LR, 227.

¹⁹⁸ Goddard 8. James, Bond LR 218.

¹⁹⁹ A third possibility might be to raise the question of whether persons in the position of Mr Ivory might have owed an equitable duty of care to the Andersons. This might be something less than a fiduciary duty, but stemming from the imbalance of knowledge and the degree of trust and reliance that was present in the relationship. This possibility is not fully examined in this paper, but given that *Trevor Ivory* is high Court of Appeal authority, there may be value in considering the “resurgence of equity” as an argument in order to argue for justice in a particular case.

undertake a project of physically large proportions, such as building a railway. Such a project was often risky, and limited liability was a necessary “carrot” in order to encourage wealthy investors to make their capital available for the “benefit of the nation”, so to speak. The projects were necessary to develop and industrialise Britain. The carrot was attractive because it enabled the attainment of significant investment rewards with a significant limitation of the associated risk. No average entrepreneur had sufficient capital to undertake these projects without investment from other sources. The legislature could be said to have reflected this “accumulation of capital” aspect by requiring at least seven investors or shareholders before the privilege of incorporation (and limited liability) would be granted.

The large accumulation of wealth that was a feature of these companies meant that the companies themselves had significant assets with which they might meet any claims.

In addition, a key feature of these companies was the separation of ownership and control: shareholders were generally investors only who invested their money leaving somebody else to “do the work”. Limited liability therefore removed the need for them to have to constantly monitor the activities of directors for fear of personal liability.

For these reasons, the liability of investors in “essential” companies was limited to the amount invested.

2. *Efficiency arguments for limited liability*

The economic arguments in favour of limited liability are usually analysed in terms of the “essential company concept” and then extrapolated unquestioningly to small companies where there is no separation of ownership and control. What are the economic arguments in favour of limited liability, and do they apply equally to companies such as Mr Ivory’s?

In answering this question, it is convenient to consider three types of company creditors:

- (i) contractual creditors, otherwise known as trade creditors or “voluntary creditors”;
- (ii) tort creditors, such as a pedestrian unsuspectingly knocked down by a person driving a van in the course of a company’s business. These are otherwise known as “involuntary creditors”;²⁰⁰
- (iii) tort creditors, such as the Andersons in the *Trevor Ivory* case, who were injured by the defendant’s negligence in the course of carrying out a *contract* that the Andersons had with the defendant company. There is some debate over to whether such victims should be classified as voluntary or involuntary creditors.

Efficiency arguments are usually analysed in terms of the first category: contract creditors, the type of creditors at issue in the *Salomon* case.

(a) transaction costs

It is argued that the corporate form reduces transaction costs. Prior to the 1855 Act, companies were achieving limited liability by contracting on limited liability terms in each case. This required contracts between each trade creditor and each shareholder in each case. Obviously, in the case of a large company with even only a few shareholders this was time-consuming. The corporate form allowed a separate company to enter into one contract on behalf of all its shareholders, thereby reducing transaction costs. That is, it removed the need for each shareholder to contract with each trade creditor on the specific issue

²⁰⁰ I use this example for ease of analysis, aware that ACC in New Zealand would more likely than not remove the ability for such a victim to sue in tort.

of limited liability. The trade creditors were taken to know that each shareholder's liability was limited simply by the use of the corporate form. In the case of a large company, the use of such a "standard contract" reduced transaction costs and was therefore "efficient".

The corporate form also facilitates the transferability of assets, by making available the option of a transfer of shares rather than a transfer of the assets individually. However, limited liability is not necessary for this to occur. Further, it is more common for the individual assets to be specifically transferred anyway, as a transfer of shares may incorporate an associated transfer of hidden company debts.

(b) shareholder monitoring costs

A second efficiency argument for limited liability is that limited liability reduces *shareholder monitoring costs*. In a situation of *unlimited* liability, if each shareholder is jointly and severally liable for the debts of an organisation, any one shareholder's individual liability in the event of company failure will be directly affected by the solvency of the other shareholders. For example, if one of the shareholders becomes bankrupt, that shareholder's share of the burden will have to be picked up by the remaining shareholders. They will have to pay more than their proportionate share because the bankrupt shareholder will pay less than his or her proportionate share. As each individual shareholder's risk exposure is therefore directly affected by the solvency of the other shareholders, shareholders acting "rationally" will monitor the wealth of their co-shareholders in order to monitor their own position.

In a situation of general *limited* liability on the other hand, each shareholder's exposure is "capped" at the amount unpaid on the shares. As their situation will therefore not be affected by the bankruptcy of a co-shareholder, the need to monitor the co-shareholders' position is eliminated. Of course, if a situation

of pro rata rather than joint and several unlimited liability were adopted, this argument would fall down. In a situation of pro rata unlimited liability the total shortfall on failure of the company is allocated between all the shareholders in proportion to their shareholding. Their exposure is capped at this amount. If one of the other shareholders declares personal bankruptcy, their debt to the company's creditors is proved along with his or her other personal debts. If it is not met, it is not picked up by the other shareholders, and the total pool available to the company's creditors is simply reduced (as is customarily the case with limited liability). However, the efficiency argument for limited liability on the grounds that it reduces shareholder monitoring costs therefore falls down because the same reduction can be achieved under an unlimited liability situation if pro rata rather than joint unlimited liability is in place.

(c) enforcement costs

A third argument is that limited liability reduces *enforcement costs*.²⁰¹ In the event of the insolvency of a large publicly-listed corporation, a victim could potentially have to sue each individual shareholder in an unlimited liability situation. This would be time-consuming and maybe unfruitful, if, having located a shareholder, they were of insufficient means to meet the claim. Limited liability reduces this cost by limiting recourse to the company only.

(d) other arguments

In addition, limited liability facilitates the accumulation of capital for the purpose of undertaking large projects. As was seen in the debate preceding the Limited Liability Act 1855, such projects may have benefit for the economy and where they would be unlikely to be undertaken either by one person individually, or by accumulated investors in a situation of *unlimited* liability, a general limited liability regime is of benefit.

Trade creditors are argued to know that they are dealing with a limited liability company; they can therefore adjust their rates of credit accordingly. Further, the principals of companies want to continue receiving credit from such creditors, and in order not to upset them, will take their considerations into account in making decisions about the company. The costs of the creditors' risk are thereby internalised to the company with efficiency resulting.

Finally, it is argued that limited liability places the risk of loss most efficiently on the person best able to bear that risk. Obviously, someone must bear the loss when a company collapses owing more than its assets. Limited liability shifts the burden of that loss onto the creditors of the company so that instead of the shareholders suffering a depletion of their personal assets, the creditors instead suffer that depletion.²⁰² It is argued that creditors bear this risk of loss more cheaply than do shareholders. Indeed, they were contracting on these terms before limited liability was brought in, reflecting the fact that the market found this to be more efficient. The legislation simply reflects that and makes it less costly by providing a "standard contract".

3. *Evaluation with respect to tort creditors of one-person companies*

Arguably these arguments do not apply to companies that do not fall within the "essential company concept". Further, they arguably do not apply where the creditor is a tort victim as opposed to a business person who contracted with the company at arm's-length in the course of trade. This is particularly the case where a tort victim falls into the second category. Where there was no contract with the company, the tort creditor had no opportunity to bargain to have the risk to him or her taken into account. Efficiency is arguably precluded in such a situation.

²⁰¹ Hansmann above n 12, 1899.

²⁰² Pettet 146.

(a) transaction costs

One-person companies by definition have only one shareholder. Therefore, contracting between each creditor and the shareholder on each business transaction is arguably no more onerous than contracting with the company. There is no reduction of transaction costs. One could argue that it removes the need for the shareholder to have to raise the issue of their desired limited liability. However, this factor is arguably what caused the problems in the *Ivory* case. If the parties in the case had contracted openly on the issue of liability in the first place the dispute would have been forestalled.

In addition, tort creditors of the second category by definition do not contract with the company, so there are no "transaction costs" of this nature to reduce.

(b) shareholder monitoring costs

With a one-person company, there are no other shareholders to monitor by definition. No efficiencies are achieved in this respect when a one-person company is at issue.

(c) enforcement costs

Limited liability may reduce enforcement costs by limiting recourse to the company only. However, where there is only one shareholder, pursuing the shareholder is unlikely to be a particularly onerous additional cost. Furthermore, where, as is customarily the case with small companies, there is no money to meet claims, creditors may well wish to retain the option of pursuing shareholders individually in order to retain any hope of achieving any compensation at all.

(d) other arguments

Limited liability arguably facilitates the accumulation of capital for the purpose of undertaking large projects. However, one could argue in response that now that the industrial revolution is passing, the need for this accumulation is passing also. There is no widespread demand in New Zealand of the 1990s for big ships, big railways or big industrial steel mills on a wide scale in order to develop the nation as there was in Britain last century. There is not the same social context that led to the political achievement of the Limited Liability Act in 1855. In addition, one-person companies are not an "accumulation of wealth" by definition.

In addition, it has been argued that contract creditors bear a loss more efficiently than shareholders do because they can insure against the risk of that loss and can factor any insurance cost into the cost of their credit. That this might not have been the case with Mr Ivory is discussed above. Further, tort creditors do not have such opportunity. In the current regime, Mr Ivory has no incentive to carry insurance or really to take care. But arguably, with respect to *tort* debts rather than contract debts he is in a better position to bear the loss. He is in a better to monitor whether or not he is taking care.²⁰³ He is subsidised by the insurance of his tort creditors at no cost to him. The current regime encourages the undertaking of hazardous activities with insufficient precautions and insurance.

Why is there such a proliferation of small companies in New Zealand? Is it because of a New Zealand fondness for the corporate form as part of a general fondness for having one's own small business? Is it because small companies provide value to the economy? Or is it simply human nature: limited liability allows increased return for reduced risk. It allows one's own losses to be shifted so that they are borne by other people. It must be remembered that

²⁰³ See Halpern above n 4, 145-149..

most small businesses fail within their first few years. Limited liability might indeed be one last example of a “free lunch”.

If the removal of general limited liability, and the ability to “externalise the risk of uncompensated harms”, causes some businesses to go out of business then they can’t have been efficient in the first place. Their costs were not worth their benefits.

Importantly, significant legislative inroads have been made into limited liability in the interests of “efficiency”. For example, when a company starts to approach insolvency a principal is less likely to care about ongoing relationships with creditors. The principal is instead more likely to take risks to keep the company afloat as by that stage the principal is gambling with the creditors’ money and favouring his or her own. The legislature has recognised that this is inefficient as the creditors’ interests are thereby externalised from the director’s decision-making process. Consequently, section 135 of the Companies Act 1993 was passed to impose *personal* liability on a principal that trades recklessly while approaching insolvency. This restores the internalisation of the creditors’ interests in this situation and thereby restores efficiency.

If this is the situation with respect to voluntary trade or contract creditors, arguably some corresponding response is required in the case of the second group: that is, tort creditors who by definition do not contract with the company and so cannot bargain to have their increased risk of loss taken into account. With respect, the precedent value of the decision in *Ivory* is significantly diminished because it does not address these arguments. It seems to assume that finding liability on the part of Mr Ivory would undermine the principle in *Salomon*, but *Salomon* never contemplated the *Ivory* situation. At the very least, that should have dictated a full examination of the merits or otherwise of a strict application of *Salomon* in that case.

However, even if a law change is indicated with respect to tort victims of the second group, it is argued that such a change should not be extended to tort victims in third group (that is, tort victims like the Andersons who also happened to have a contract with the company). It is argued that people in this position do have an opportunity to contract on the relevant risks and have those risks taken into account in the relevant bargain. To then be able to bring a tort action against the director personally would be "using tort to supplement a contractual bargain".

However, certainly in the case of the Andersons, this cannot be correct. In fact, it does not seem correct to differentiate a third category in such a case at all. The Andersons were involuntary creditors in the same way as any other tort victim because they were never intending to be "creditors" at all. In fact, the original intention was that cash would only flow in one direction: from the Andersons to Mr Ivory, for services rendered, and not the other way around. Could they have taken the risk of the negligence into account in the contractual bargain? Perhaps, but where, as here, they did not do that, surely the tort action remains. This must be particularly the case with respect to one-person companies the mere existence of which is challengeable on economic efficiency grounds. Further, the existence of the company arguably "befuddled" the contract. It prevented the parties from actually bargaining on the relevant issue. Mr Ivory had no incentive to bring up the issue of liability. In fact, he had an incentive to keep it quiet, because knowledge of this risk might have prevented the Andersons from entering this contract at all (an indication of the market at work).

4. *The purposes of company law*

The Companies Act 1955 prohibited one-person companies. However, it was easily possible to avoid this rule by a principal simply having one share held by a nominee, often the principal's spouse or professional adviser.

The Companies Act 1993 recognised that this prohibition on one-person companies was being widely flouted. In what might be termed a standard “commercial reality” response typical of this area the new Act specifically allowed companies to be incorporated with one shareholder only.

This was a significant change. However, I would argue that it is more a reflection on the part of the legislature of the ease with which the corporate form can be manipulated to circumvent boundary rules than it is a policy decision that incorporation is appropriate for one-person businesses. Indeed, the Companies Act 1993, with its “one-size fits all” set of off-the rack rules, has been argued to be clearly inappropriate for small, closely-held companies such as Mr Ivory’s. Its notification and reporting requirements are clearly predicated on the separation of ownership of control that is a feature of large probably public-listed companies, (that is, companies that fall within the “essential company concept”). Indeed, the increased penalty exposure that incorporation now brings has made criminals out of most small companies in New Zealand. This is interesting given that most of the companies in New Zealand, perhaps even 90%, are small. Could the legislature be trying to discourage the use of the corporate form for small businesses such as Mr Ivory’s?

What is gained by incorporating a small one-person business nowadays? On the one hand a director of such a company faces exposure to criminal penalties for failing to comply with onerous requirements which arguably serve no value whatsoever where ownership and control are merged. The mechanisms in the Act for circumventing these rules²⁰⁴ have serious limitations. Section 135 and other sections expose the director to unlimited personal liability. In addition, banks’ personal guarantees expose directors to further personal unlimited liability. Companies of course can grant floating charges, but a review of the personal property securities legislation seems likely to extend this ability to natural persons. Now that tax rates are flatter, and the company

rate matches the top personal rate, there seem few tax incentives for incorporating a small business. It is difficult to get money out of companies, and dividends contain a degree of double taxation.

Other than romantic notions of perpetual succession, the only real reason for incorporating a business seems to be where there is a concern that the business might go under, coupled with an associated desire to have somebody else bear the risk of that loss. In other words: to achieve limited liability and thereby “escape from personal liability and responsibility”²⁰⁵ (to the extent to which limited liability remains).

Are these valid reasons for retaining the privilege of limited liability, at least for small businesses?

The long title states that the Companies Act 1993 is to reform the law relating to companies, and, in particular:

To reaffirm the value of the company as a means of achieving economic and social benefits *through the aggregation of capital for productive purposes*, the spreading of economic risk and the taking of business risks; and...

To encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgement *while at the same time providing protection for shareholders and creditors against the abuse of management power*. (Emphasis added)

By focusing on the aggregation of capital, the legislature is arguably reinforcing the essential company concept. There is no “aggregation of capital” by definition where there is only one shareholder. The spreading of *economic risk* arguably relates to contractual trade creditors and not involuntary tort creditors. Negligence is not a “business risk” but stems from a duty every person has to take care not to injure their neighbour, whether they

²⁰⁴ Such as the constitution or a s107 assent.

run an incorporated business or not. The Companies Act reflects a clear legislative focus to have people take responsibility for their actions and to cut down on abuses of the corporate form.²⁰⁶ It sits in a legislative context which includes the consumer protection focus of the Consumer Guarantees Act of the same year, and the Fair Trading Act of 1986. The decision in *Trevor Ivory* sits most uncomfortably in this environment.

5. *Conclusions regarding company law*

How could company law be reformed in order that the correct result might be reached should the facts of *Ivory* come up for determination again?

(a) remove the ability to incorporate one-person businesses

It seems there is a significant case for the removal of the ability to incorporate one-person businesses.²⁰⁷ Historically and economically there seems little basis for granting the privilege of blanket limited liability to such companies, particularly one-person *advice* businesses which by definition are personal in nature and generally have little asset-backing. Lawyers and accountants are currently unable to incorporate. This prohibition should be retained and extended to other advice businesses.

Such a removal of limited liability would encourage principals of one-person advice businesses to consider the full social costs of their decisions;²⁰⁸ it would force the principals to contract openly on the issue of liability. This scenario seems to function perfectly adequately in the case of lawyers and

²⁰⁵ Fridman above n 7, 53.

²⁰⁶ Companies Act, s135, for example.

²⁰⁷ See also Todd above n 7, 520 for a discussion of the special problems created by one-person advice businesses.

²⁰⁸ Hansmaan above n 12, 1906.

accountants.²⁰⁹ It certainly creates no more problems in that area than the ability to incorporate one-person advice businesses has arguably caused for people such as the Andersons.

The inappropriateness of the Companies Act 1993 for one-person companies has already led to calls for a separate closely-held company Act, along the lines adopted by the United States.²¹⁰ However, reducing the burden on directors in terms of notification and reporting requirements would not address the problems caused by cases such as *Trevor Ivory*. It also does not answer the fact that there does not seem to be a justification for a blanket granting of the privilege of limited liability for such companies. It seems that, rather than a separate Act, a specific exclusion would be preferable.

Such an exclusion would clearly have to be instituted by the legislature rather than the courts. While acknowledging that there is a legion of corporate veil-piercing jurisprudence, I respectfully agree with the comment that, in terms of the *Salomon* context, "once an inquiry is admitted into where lies the beneficial ownership or control of company shares, the difficulty of inferring workable limits to the statutory right of incorporation with limited liability becomes practically insuperable".²¹¹

The difficulty with this approach, however, would be in drawing the boundaries. The one-person rule was easily side-stepped in the 1955 Act. An "advice" business would be difficult to define and easy to circumvent as well. Boundaries are notoriously difficult to maintain in this context.

(b) limit the ability to incorporate one-person businesses

²⁰⁹ See Pettet above n 13, 140-141. There is always the issue of placing assets in the hands of judgement-proof individuals such as trusts, however. See Hansmaan above n 12, 1885-1886 and 1909-1915.

²¹⁰ Robert Dugan *Companies Act 1993 – Governance Issues for Closely-Held Companies* (Victoria University of Wellington Law Review, 1997).

Perhaps a solution could be to make it more *difficult* for a one-person business to achieve the privilege of incorporation. For example, it has been argued that businesses should not be allowed to incorporate unless they do so with sufficient capital to meet any likely claims. A “minimum capital requirement” has generally been rejected as a solution to any problem in this area, however, for various reasons. For example, what is “adequate” capital for any given business? What capital should Mr Ivory have incorporated his business with in order to ensure in advance that there would be sufficient money to meet any claims?

In addition, minimum capital requirements can be easily circumvented; for example, company capital can be eroded by over-leveraging the assets of the business (within the requirements of the solvency test perhaps but outside a minimum capital requirement).

Further, a minimum capital requirement might be argued to inhibit the incorporation of some businesses that would have been of value to society, while having little impact on those businesses that would not.

Generally a minimum capital requirement is not favoured as a solution to the problem at hand. However, arguably it would have value as an additional protection. In contrast to the ease with which companies can be formed today, a minimum capital requirement would at least send a message that care is expected in the use of the corporate form.

In a similar vein, an administrative change could be instituted. Instead of a “no-questions-asked” approach when registration of a company is sought, potential incorporators could be required to *justify* why they and their business should be granted the privilege of limited liability. Again this might ameliorate the problem at issue, but it seems unlikely it would solve it.

²¹¹ *Turning Points* above n 28, 10.

(c) compulsory insurance

Compulsory insurance might not be a bad idea. On current legislation, Mr Ivory had no incentive to insure fully as his tort creditors were effectively subsidising him. Compulsory insurance would provide compensation for tort creditors such as the Andersons, and it would also promote more full internalisation of costs: too many claims against him would raise the costs of that insurance to Mr Ivory. This would at least provide some incentive to take care. However, there are many difficulties with a compulsory insurance approach, and from a practical perspective, it would be very unlikely that such a regime would be implemented.

In the final analysis, while some reform of company law may ameliorate the problem at issue, the corporate form is too fluid to allow any boundaries to be effectively created in this area. There are also conflict of laws issues if countries have different rules.²¹²

It seems that any effective reform in this area must be through the law of tort.

B Reform Tort Law

A company law analysis effectively considers Mr Ivory as a shareholder, and considers to what extent his liability should be limited to the amount unpaid on his shares. A tort analysis on the other hand considers Mr Ivory as a director, acting in his own right. This seems inherently more correct.

The reform of the law of tort would be much more simple. The fundamentals are already in place. When the issue of the personal duty of care of a director is raised, one should simply perform the analysis prescribed by the Court of Appeal themselves in *South Pacific*. The House of Lords' authority of *Henderson and Williams* would also be appropriately considered.

A *director* should be made to bear the consequences of his or her own negligence in a case such as *Ivory*, independently of any considerations of limited liability. It is no answer that Mr Ivory is a shareholder as well. Limited liability was never intended to provide a shield against the requirement to take care. The existence of a company may be a reasonable disclaimer of liability on a given set of facts. However, a contra preferentim principle must be applied in this context: those seeking to claim the privilege of limited liability, particularly with respect to tort creditors, must be required to prove that limited liability was *actually* contracted for. People in the position of the Andersons cannot be left to bear such losses simply because of a 19th century "sleight of hand".²¹³

If this approach effectively removes limited liability for one-person companies then that is the market moving to the most efficient outcome. Retention of limited liability almost for its own sake is a distortion.

It might be argued that people would cease to be directors. This argument might be met by saying that is simply the market moving to a more efficient outcome. The people who would become directors are those who want to contribute their entrepreneurial skills and are prepared to take reasonable care in the process of doing so. The requirement to take reasonable care is imposed on every person in society. Directors should not be excluded.

VIII CONCLUSION

The decision in *Trevor Ivory* seems premised on an unexplained deference to the case of *Salomon* and company law generally. However, the concept of a limited liability company is only a metaphor. *Salomon* can be heavily criticised at several levels. It should be seen in its historical, social and political context. The law of tort has developed significantly since 1897.

²¹² Such as the South African-United States asbestos case, Hansmaan above n 12, 1922.

²¹³ That is, *Salomon* above n 10

Salomon is only a case, the same as any other. It should not be afforded reverential treatment other than on its intrinsic merits. Those merits should be fully examined. One commentator made the following comment in a slightly different context:²¹⁴

Unless they are applied in recognition of the changes brought about by technological and economic progress, jurisdictional concepts which may have been reasonable enough in a simpler economy lose their relation to reality, and injustice rather than justice is promoted.

Arguably, the sentiment applies equally here. The decision in *Trevor Ivory* is wrong and the law should be correspondingly reformed. While reform of company law may be inadequate in this area, it would be quite appropriate, and indeed essential, to reform the law of tort to restore a better balance. Arguably, the law of tort already indicates that *Trevor Ivory* is wrong. However, the case of *Trevor Ivory* is still good law. It should be overruled.

Limited liability is a privilege, not a right. It should not blind us to the purposes of the law, namely: to cause people to live honestly, not to harm others and to give each their due.

²¹⁴ D Wille "Personal Jurisdiction over Aliens in Patent Infringement Actions: A Uniform Approach Toward the Situs of the Tort" (1991) 90 Mich L Rev 658, 658 cited in Miles McCarthy "The Territoriality of Intellectual Property Infringement Actions" [1997] LLB(Hons) Research Paper, 1.

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