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THE TORTIOUS LIABILITY OF THE ONE-PERSON COMPANY DIRECTOR

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ABSTRACT

A significant number of New Zealand companies are effectively controlled by one person who is usually the main shareholder and the executive director. If a tortious act is carried out by that person in a situation in which the company is the primary tortfeasor and the director is acting for the company, an "interesting and difficult" question arises as to the personal liability of the director. The doctrine of separate corporate personality establishes that the company is a distinct legal entity and as such it should be liable for its torts. It is also true that a director, like any other person, should be responsible for his or her own torts. However, a one person company director will be the "controlling mind" of the company to such an extent that it will be difficult to see why the director should escape liability from tortious conduct through the vehicle of a corporate entity. This paper seeks to determine in what circumstances the courts will find a director personally liable through an analysis of the various tests that have been identified by the courts. These tests will be considered in the light of the separate corporate personality doctrine.

The text of this paper (excluding contents page and footnotes) comprises approximately 12, 038 words.

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I INTRODUCTION

A significant number of New Zealand companies are effectively controlled by one person who is usually the main shareholder and the executive director. If a tortious act is carried out by that person in a situation in which the company is the primary tortfeasor and the director is acting for the company, an "interesting and difficult"[1] question arises as to the personal liability of the director.

The doctrine of separate corporate personality establishes that the company is a distinct legal entity and as such it should be liable for its torts.[2] It is also true that a director, like any other person, should be responsible for his or her own torts.[3] However, where the director exercises the degree of control common in a one person company it may be difficult to distinguish whether the tortious act should be attributed to the company or to the director. A number of tests have been formulated to deal with the issue but these often analyse responsibility according to the level and nature of the director's personal involvement. However, in the one-person company situation a director will almost always be fully involved in the company's actions and there is a danger of making such a director liable in almost every situation, despite the fact of incorporation. This paper seeks to analyse the tests developed by the judiciary to decide whether a director may be found liable for a company tort and assess their usefulness in the one person company context.

II THE DIRECTOR'S TORT OR THE COMPANY'S TORT

A director will escape liability for a tortious act if that act is imputed to the company either through the rules of attribution or because that director is identified with the company. In such a circumstance only the company may be liable. Alternatively, the director may be considered to have acted as the agent of the company and in acting as an agent may in some situations become

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[1] *Centrepac Partnership & Ors v Foreign Currency Consultants Ltd & Ors* (1989) 3 NZCLC 64,940, 64,950.

[2] [1897] AC 22.

[3] *Yuille v B & B Fisheries (Leigh) Ltd* [1958] 2 Lloyd's Rep 596, 619.

personally liable as a joint tortfeasor with the company.[4] A tortious act will normally be considered that of the company unless there is clear evidence that the director was acting as the company's agent "in a way that renders him personally liable".[5] Prior to considering how the director can act in such a way as to become personally liable, the rules of attribution, identification and agency will be discussed in so far as they are relevant to the one person company director.

A The rules of attribution

A corporation is a statutory creation that can only act because the law attributes to it certain actions of its directors or officers. In *Meridian Global Funds Management Asia Ltd v Securities Commission* [6] Lord Hoffmann explained that the primary rules of attribution which show whether particular acts or knowledge belong to the company can be found in the Companies Act 1993, in the company's constitution and may be implied by company law. However, if the answer is not found there the enquiry will be extended to the principles of agency and vicarious liability.[7]

1 Agency

A director may be described as an agent of the company but it is important to distinguish whether this agency is present in the legal sense, where a person is engaged to bring the principal into contractual relations with third parties,[8] or merely in the popular sense.[9] If a "popular" agency is present the director will be doing no more than acting as the company's "hands" and thus only the company should be liable. If true agency is established it will be necessary to ascertain the limits of the authority conferred by the principal, or company, on the director. Personal liability should only arise

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[4] JH Farrar, *The Personal Liability of Directors for Corporate* Torts, (1997) 9 Bond LR, 102.
[5] *Trevor Ivory v Anderson* [1992] 2 NZLR 517, 527.
[6] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 3 NZLR 7.
[7] n 6, 11.
[8] Butterworths Commercial Law in New Zealand (3rd ed) (Butterworths, Wellington, 1996) 489.
[9] n 5, 526 per Hardie Boys J.

where the tortious act was outside the actual or ostensible authority of the director.

The one person company director will almost always be an agent in the popular sense because of the heavy level of involvement in the business such a person tends to undertake. That director will most likely have the authority to bind the company contractually but it is unlikely that the given authority would include carrying out tortious acts. An exception may be where a company is incorporated specifically to act in a tortious manner, for example, to infringe another's copyright. There the tortious act can be seen as that of the company and on one analysis the true tortfeasor succeeds in hiding behind the "veil of incorporation". However, in *Yuille v B & B Fisheries (Leigh) Ltd* [10] it was held that directors could not claim the protection of separate corporate personality where the company had been formed for the purpose of committing a wrongful act. Lord Salmon later agreed with this finding but added that each case would depend on its own facts.[11]

Beck has criticised agency as inappropriate "to explain the economic unity which occurs in the one person company" and adds that a genuine rather than a contrived agency must be found.[12] Thus, it will be necessary to analyse the director's relationship with the company to ascertain the type of agency which exists.

In *Meridian* Lord Hoffmann noted that principles such as agency may be of limited use where a rule requires a certain act or state of mind on the part of a particular person rather than that person's servants or agents.[13] His Lordship considered that in such cases the court should devise a special rule of attribution for the particular substantive rule. This would require asking how the act was intended to apply to a company and whose act was for that

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[10] n 3.
[11] *Wah Tat Bank v Chan Cheng Kum* [1975] 2 All ER 257.
[12] A Beck, "The two sides of the corporate veil" in *Contemporary Issues in Company Law*, Professor Farrar (ed) (1987) 69, 75.
[13] n 6, 12.

particular purpose intended to count as the act of the company.[14] Such an enquiry would involve considerations of statutory interpretation and the content and policy of the rule.

Thus, in *Meridian* knowledge of a security interest was attributed to the company as soon as it was known to an employee acting with authority because the purpose of the securities legislation was rapid disclosure and in that context there was no time to wait until the knowledge had been conveyed to senior management. Thus, where a state of mind is necessary for the particular rule, the enquiry may move from considerations of employment or agency to a purposive analysis of the relevant statute or rule.

2 Vicarious liability

A company will be vicariously liable for the torts of its employees.[15] This may lead to an enquiry as to whether the director is an "employee" who was acting in the course of his or her employment in carrying out the tortious act.[16] If the director was acting outside the bounds of his or her employment then the act may qualify as a personal one for which the director is liable. In *Lees v Lee's Air Farming Ltd* [17] it was held that a director of a one person company could be described as an employee of that company even though this may seem 'artificial'.

A more difficult question may be whether the act was carried out in the course of the director's employment. This requires an application of tests such as that the director "not only order what is to be done, but how it shall be done"[18] or to ask whether the act carried out was an integral part of the business of the company.[19] In a closely held company it is likely that these tests would be made out so that in this the director will usually be held to be acting in the course of employment.

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[14] n 6, 12-13.
[15] *Lloyd v Grace, Smith & Co* [1912] AC 716.
[16] J Payne, *The Attribution of Tortious Liability between Director and Company* (1998) JBL 160.
[17] [1961] NZLR 325.
[18] *Collins v Hertfordshire County Council* [1947] KB 598, 615.
[19] *Lee Ting Sang v Chung Chi-Keung* [1990] 2 AC 374 (PC).

A criticism of attribution is that it allows executive directors to avoid liability because of a legal fiction deeming that their acts are those of the company when other employees remain liable.[20] However, in *Americano's Ltd v State Insurance Ltd*[21] the arson of the company's chef was attributed to the company where the insurance policies stated that there would be no cover for damage "occasioned by the wilful act or with the connivance of the insured". The facts of the case showed that the chef was effectively a 25% shareholder who had masked his involvement to obtain a liquor licence for the company. Although the case involved an insurance claim within the context of a criminal act, it is instructive to note that the High Court was willing to look to the substance rather than the form of the incorporation to attribute the act to the chef/shareholder. The court looked to the true role of the chef within the company, whether that role provided a motive for arson, whether the chef could sensibly be regarded as acting *for* the company (burning the premises was not *for* the company), the nature of the relationship between the arsonist and the others involved in the business and a consideration of the consequences of a decision either way.

B Identification

An alternative analysis is found in *Tesco Supermarkets Ltd v Nattrass*[22] which laid down the "living mind and will" doctrine. A key passage from Lord Reid follows:

> "A living person has a mind which can have knowledge or intention or be negligent and he has hands to carry out his intentions. A corporation has none of these: it must act through living persons, though not always one or the same person. Then the person who acts is not speaking or acting for the company. He is acting as the company and his mind which directs his acts is the mind of the company. There is no question of the company being vicariously liable … He is an embodiment of the company …It must be a question of law whether, once the facts have been

[20] D Wishart, *The Personal Liability of Directors in Tort* (1992) 10 C & SLJ 363, 365.
[21] (1999) 6 NZBLC 102,892.
[22] [1972] AC 153.

> ascertained, a person in doing particular things is to be regarded as the company or merely as the company's servant or agent. In that case any liability of the company can only be a statutory or vicarious liability."[23]

In *Nordik Industries Ltd v Regional Controller of Inland Revenue Supreme Court*[24] a director was identified as his company's "self" so that a charge against the director for defrauding that company could not be made out because "a person cannot defraud himself". Applying the *Tesco* decision Cooke J, as he then was, found that the person who speaks and acts as the company and who is in control of the company is not the company's alter ego but is instead identified with the company. Cooke J quoted Lord Reid in *Tesco* who said that it is possible for the board of directors or the memorandum and articles of association of a company to delegate the exercise of the powers of the company to certain people who are thereby identified as acting as the company. In this case this meant that the director's knowledge of the falsity of the returns could be attributed to the company. Given the mental element necessary in a charge of fraud, this would seem to fit with the extraordinary circumstances procedure of Lord Hoffmann in *Meridian*.

A director of a nominee company was personified and identified with that company in *Kendall Wilson Securities Ltd v Barraclough*[25]. In *Ivory* Cooke P reconciled these cases with the finding of separate legal entity in *Lee v Lee's Air Farming Ltd*[26] by saying that *Kendall* and *Nordik* involved the company's interactions with the outside world while *Lee* dealt with the relationship between the company and the shareholder.[27] Thus in *Ivory*, which involved a company's alleged negligence against a client, the *Tesco* directing mind and will doctrine was considered useful in deciding the case. Cooke P added 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."

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[23] n 22, 170.
[24] [1976] 1 NZLR 194.
[25] [1986] 1 NZLR 576.
[26] n 17.
[27] n 5, 520.

It can be argued that the client is aware they are dealing with a company and sees the person as merely an extension of that company.

Decisions such as *Tesco* where directors were described as "being" the company were based on interpretations of the relevant statutes, often in the context of imposing criminal or regulatory liability. The relevant "rule" was intended by the judiciary or the legislature to charge the company for the acts done by its agents or employees as if the company had committed the acts itself.[28] Thus, the doctrine is limited to certain contexts. Cooke J recognised this limitation in *Nordik* but added that *Tesco* provided important guidance on matters of general principle. Lord Hoffmann warned that to analogise a company fully with a natural person in this way was dangerous because:

> "this anthropomorphism, by the very power of the image, distracts attention from the very purposes for which . . . the notion of directing mind and will [is used], namely to apply the attribution rule derived from the specific statutory rule in question." [29]

Thus, anthropomorphism should be confined to its proper place in the relevant statutory context. An over-emphasis on the legal person metaphor can be misleading because it implies moral and physical presence when the company's personhood is no more than a legal fiction.

The directing mind or "organic theory" has been criticised as a "grotesque anthropomorphism"[30] by Wishart who argues that companies are often too large and diffuse to identify one particular area of decision making. In *Livingstone v Bonifant* [31] it was held that the protection of incorporation was more important in the case of a large company where errors could more easily escape the notice of the principal shareholder than in the case of a one person

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[28] JW Neyers, *Canadian Corporate Law, Veil-Piercing and the Private Law Model Corporation,* 50 Univ of Toronto LJ 173, 229.
[29] n 6.
[30] D Wishart, *Company Law in Context* (Oxford University Press, Auckland, 1994) 144.
[31] (1995) 7 NZCLC 260, 657.

company.

III THE PRIMACY OF COMPANY LAW

A The pre-eminence of the separate corporate personality doctrine

The primary hurdle to a finding of personal liability against a director lies in the doctrine of separate corporate personality. A company cannot commit a tortious act without the aid of human agency and it is argued that those "agents" are merely carrying out the company's tort and should not be liable. The separate corporate entity doctrine was laid down in the leading English case of *Salomon v Salomon*[32] which established that even a one person company is at law a different person from its subscribers.[33] Their Lordships held that the corporate entity could not be considered a trustee or agent for Mr Salomon. This principle is fundamental to company law and is commonly revered by judges and academics alike.[34] This is largely because the principle and its limited liability cousin allows capital to be collected from a number of investors over time and avoids transfer costs when new members are admitted or the business is sold.[35]

B Piercing the corporate veil

If a company tort has been carried out by a director and a plaintiff seeks to sue the director personally an objection may be that this will involve "piercing the corporate veil". Despite the importance of the separate legal personality doctrine, the courts have arguably done this in a number of situations.[36] For example, where it can be shown that the company was a mere façade a court may be willing to go behind the corporate entity to find the director liable.[37] Further, a special agency relationship may be created which allows the court to attribute liability on agency principles,

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[32] [1897] AC 22 (HL).
[33] n 32 per Lord Macnaghten.
[34] R Grantham & C Rickett, "The Bookmaker's Legacy to Company Law Doctrine" in *Corporate Personality in the 20th Century*, R. Grantham & C. Rickett, eds., (Oxford, Hart Publishing, 1998) 1.
[35] D Goddard, "Corporate Personality – Limited Recourse and its Limits" in *Corporate Personality in the 20th Century*, R Grantham & C Rickett, eds, 18.

although this is not considered to be true veil piercing.[38] A court will consider whether this action will threaten the objectives of separate personality such as the limited liability of shareholders.

A survey of New Zealand jurisprudence reveals that the courts have preferred to uphold the pre-eminence of the separate corporate personality doctrine in all but the most extreme situations. In *Savill v Chase Holdings (Wellington) Ltd; Concept Investments Ltd v Savill* [39] it was held that "… it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere façade concealing the true facts."[40] The superiority of corporate form over substance has been further upheld in other cases including *Cricklewood Holdings Ltd v CV Quigley & Sons Nominees Ltd* [41] which stated that the corporate veil may possibly be lifted in the case of a bare trust.

In *Attorney-General v Equiticorp Industries Group Ltd (In Statutory Management)* [42] where the chairman and chief executive had virtually decided which company within a group of companies should be used for a particular acquisition or transaction, it was argued that this meant that one company within the group of companies could be seen as the implied agent, trustee or partner of the other companies. Although this description of a group of companies as a single economic unit has been accepted in some circumstances,[43] the Court of Appeal rejected the argument as inconsistent with the judgment of the House of Lords in *Salomon* and of the Privy Council in *Lee v Lee's Air Farming Ltd.*[44] They noted that in *Salomon* the House of Lords rejected the idea that agency could be used to impugn the non-liability

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[36] A Beck, "The two sides of the corporate veil" in *Contemporary Issues in Company Law*, Professor Farrar (ed) (1987) 69, 72.
[37] *Woolfson v Strathclyde Regional Council* 1978 SLT 159 HLSc.
[38] PL Davies, Gower's Principles of Modern Company Law (6th ed) (Sweet & Maxwell, London, 1997) 173.
[39] [1989] 1 NZLR 257.
[40] n 30, 279, citing the test from *Woolfson v Strathclyde Regional Council* [1978] SC 90 (HL).
[41] [1992] 1 NZLR 463; Bare trust also considered a possible situation for piercing the corporate veil in *Kendall Wilson Securities Ltd v Barraclough* [1986] 1 NZLR 576.
[42] [1996] 1 NZLR 528.
[43] n 38, 166.
[44] [1961] NZLR 325.

of members for the acts of the corporation. The Court of Appeal said it was possible to look behind the corporate façade and identify the real nature of a transaction and the reality of the relationship created. However, in this case the contracts were accepted as genuine and the Court saw no need to look behind them to ascertain the true position.

The Commonwealth courts have recognised that a finding of tortious liability against a director may threaten the separate corporate personality doctrine and have consequently retreated from such findings in decisions such as that of the New Zealand Court of Appeal in *Trevor Ivory Ltd* v *Anderson*,[45] the House of Lords decision in *Williams* v *Natural Life Health Foods Ltd*[46] and in Justice La Forest's dissent in *London Drugs Ltd* v *Kuehne & Nagel International Ltd.*[47]

Thus, the doctrine of separate corporate personality stands as a bar to director liability. The corporate veil may appear particularly artificial in the one person company context but it is in such a context that the leading cases have upheld the separate corporate entity. However, David Goddard argues that a person's civil liability for acting wrongfully in person, in breach of non-voluntary obligations imposed by the general law will not be reduced by the presence of a corporate entity.[48] It can be argued that there is no such thing as a company which is a legal person, it is merely a 'corporate patrimony' or nexus of contracts. As such natural persons should be responsible for their torts.[49]

C Limited liability

One case where the court refused to find the director liable was *Ivory* in which Cooke P stated that the imposition of liability on the director of a one person company could erode the principle of limited liability. However, limited liability does not extend to directors but is intended to protect shareholders from responsibility beyond the value of their paid up share capital. Wishart

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[45] n 5.
[46] *Williams v Natural Life Health Foods Ltd* [1998] 2 All ER 577.
[47] (1992) 97 DLR (4th) 261.
[48] n 35, 36.
[49] Ireland, *The Myth of Shareholder Ownership* (1999) 62 MLR 41.

has described this as "fuzzy thinking"[50] but it could be argued that the very existence of the corporate veil suggests that directors are unlikely to be found personally liable where they have organised a transaction for a company and are also the main shareholder. This is especially so in the case of a one person company where the key purpose of incorporation is to achieve limited liability protection.[51] In *Ivory* Cooke P observed that the absolute nature of the limited liability doctrine was necessary to encourage business activity and safeguard the effects of incorporation.

IV TESTS FOR DIRECTOR LIABILITY

A The direct or procure test

This is the oldest test for director liability and holds that a director who has either expressly or impliedly directed or procured the commission of a tortious act may be personally liable.[52] The test does not adequately distinguish between the act of the company and that of the director[53] and consequently it is of limited use in the one person company context. Recognising this limitation the English courts have sought to find something more than that the defendant held the position of director or exercised complete control over an organisation. In *White Horse Distillers Ltd v Gregson Assoc. Ltd* [54] the court said liability on the basis of directorship alone would be "irrational" because it would contradict the legal principles underlying the creation of a one person company. This limitation was recognised in *Ivory* where Cooke P agreed that the directs or procures test may "go near to imposing liability in every case".[55] The English courts thus added a requirement of knowledge or constructive knowledge in an attempt to distinguish the director's personal acts from those of the company.[56] This was, nevertheless, a lower standard than that adopted

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[50] n 20, 363.
[51] M Stallworthy, *Company Law: Liability of Directors* (1997) ICCLR 8(5) 87.
[52] *Performing Right Society Ltd v Ciryl Theatrical Syndicate Ltd* [1924] 1 KB 1.
[53] n 4, 2.
[54] [1984] RPC 61.
[55] n 5, 520.
[56] Also *Performing Right SocietyLtd v Ciryl Theatrical Syndicate Ltd* [1924] 1 KB 1 and *Rainham Chemical Works Ltd v Belvedere Fish Guano Co Ltd* [1921] 2 AC 465.

by the Canadian courts. For example, in *Mentmore Merchandising Co Ltd v National Merchandising Manufacturing Co Inc*[57] it was held that the director needed to actually "make the act or conduct his own as distinct from that of the company".[58] The *Mentmore* test of making the tort his or her own would seem preferable for director liability in the one person company context. Such a director will direct or procure all of the company activities and this test allows an analysis of whether the act is that of the director or the company. *Mentmore* was applied in *White Horse Distillers Ltd v Gregson Associates Ltd* [59] but doubted by the Court of Appeal in *Evans (C) & Sons Ltd v Spritebrand Ltd* [60] where it was held that a director could be personally liable where he or she had directed or procured the tort and a knowing, deliberate participation in the alleged tort was held *not* to be an essential pre-condition to personal liability. Dismissing the director's appeal, the court stated that as mens rea was not a requirement in this action for copyright infringement, the plaintiffs did not have to prove a particular state of mind in the defendant.

It is instructive to note that many of the cases where the directs or procures test was used often turned on particular statutory wording.[61] For example, in the *Performing Right Society v Ciryl Theatrical Syndicate* [62] case argument turned on whether the director had "authorised" the infringement within the meaning of the relevant Copyright Act.

In the recent case of *Standard Chartered Bank v Pakistan National Shipping Corporation and Arvind Mehra* [63] the English Court of Appeal accepted that director liability may arise where the director has ordered or procured the acts of other persons which render the company liable. In that case the company had made representations in letters signed by the director and in documents presented by him which gave rise to liability in deceit . However, although the director knew the statements were false the court did not find

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[57] (1978) 89 DLR (3d) 195.
[58] [1984] RPC 61, 92.
[59] n 58.
[60] [1985] 2 All ER 415.
[61] n 4, 3.
[62] n 52.
[63] [1995] 2 Lloyd's Rep 365 (QBD).

him personally liable after analysing the decision in *Williams*. There the House of Lords had based their judgment on the pre-eminence of the separate legal personality doctrine and consequently the Court of Appeal viewed the principles of tortious liability in accordance with this rule of company law. Thus, having attributed the tortious actions to the company, the personal liability of the director was disallowed.

In *BBC Worldwide Ltd and Another v. Pally Screen Printing Ltd*[64] the defendant director was described as the "moving force" behind the company who was responsible for the relevant copyright and passing off actions. It was argued that the fact that the company was small and that the defendant was a sole director was a major factor in determining whether the director was personally liable. However, the court followed *Spritebrand* and said that no matter how small the company was and how powerful the control of the director over its affairs, it was nevertheless necessary to examine the actual part played by the director in the tortious activity. To hold otherwise would discourage commercial enterprise and lead to the unnecessary joinder of multiple parties in proceedings. It was argued that this may put unfair pressure on parties to settle and be used as a tactical move.

Both the "directs" and the "make it their own" tests have been adopted in Australian case law.[65] The majority of cases to use these tests are in the intellectual property arena. A recent case to adopt the "directs" approach was *Root Quality Pty Ltd v Root Control Technologies Pty Ltd*[66]. There Finkelstein J rejected the *Spritebrand* finding as to knowledge and held that intention was a necessary element of directing and procuring by the director where the tort was an actionable wrong to procure the violation of the legal rights of another in the tradition of *Lumley v Gye*.[67] He added that constructive knowledge following from a reckless disregard of the facts would suffice. Finkelstein J commented on the assumption of

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[64] [1995] FSR 665.
[65] *King v Milpurrurru* (1996) 136 ALR 327; *Australian Performing Right Association Ltd v Valamo Pty Ltd* (1990) 18 IPR 216.
[66] [2000] FCA 980.
[67] (1853) 118 ER 749.

responsibility test, which will be discussed below, but went on to decide the case on the directs or procures test. He commented that it would be difficult to define what amounted to "making the tort one's own". In *Mentmore* this was thought by Le Dain J to be "obviously a question of fact to be decided on the circumstances of each case". In this case, the court found that the plaintiff needed to prove that the director intentionally procured the infringement of its patent. The director's belief that selling the product in question was not a patent infringement was enough to free him from liability as in this particular instance intention was required. The relevant line of cases began with *Said v Butt* where Mc Cardie J said:

> "Nothing that I have said to-day is, I hope, inconsistent with the rule that a director or a servant who actually takes part in or actually authorizes such torts as assault, trespass to property, nuisance, or the like may be liable in damages as a joint participant in one of such recognized heads of tortious wrong."[68]

Hardie Boys J distinguished the situation in *Ivory* from the case where a director was said to have authorised, directed or procured a company tort and said in the latter situation the inquiry would be "quite different". He did not outline in what way the test would be different but it is likely that the court would have followed the English cases. It is difficult to see why *Ivory* could not have been discussed in terms of directing and procuring the tort.

B The assumption of responsibility principle

Recent case law points to a preference amongst the judiciary for the assumption of responsibility test despite its "long and chequered history as an ingredient of liability".[69] The foundational statement on that test can be found in *Hedley Byrne & Co Ltd v Heller & Partners Ltd.* [70] Since that decision a variety of circumstances have given rise to an "assumption of responsibility" including a making quasi-contractual promise, making a

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[68] *Said v Butt* [1920] 3 KB 497, 506.
[69] n 4, 111.
[70] [1964] AC 465.

choice to act or to take on a legal obligation and choosing a relationship of reliance or dependence.[71] These are of no relevance to this question because *Hedley Byrne* was distinguished in *Trevor Ivory Ltd v Anderson* [72], a case that laid down a new test for assumption of responsibility by directors, as being unconcerned with whether directors, shareholders or employees had assumed a personal duty.[73]

The facts of the *Ivory* decision were that the respondents had contracted with a one-person company called Trevor Ivory Ltd for horticultural advice and supplies. Their aim was to secure the expertise of the company's principal, Trevor Ivory. Mr Ivory subsequently gave negligent advice as to the spraying of the respondent's raspberry orchard which was destroyed causing substantial losses to the plaintiffs. The Court of Appeal accepted that a director may come under a personal duty to a third party in the course of company business and that breach of that duty may lead to personal liability. The test was whether there had been an actual or imputed assumption of a duty of care. This would depend on a balancing of policy considerations and the degree of assumption of personal responsibility present. Cooke P observed that the owner of a one person company might also assume personal responsibility but "something special" was required to justify putting it into that class.[74] According to the President, no attempt could be made to determine in advance what would amount to something special. He adopted the reasoning of the British Columbia Court of Appeal in *Sealand of the Pacific v Robert C McHaffie Ltd* [75] where it was held that although the company may have contracted with the McHaffie Ltd for the expertise of Mr McHaffie, the contract was between McHaffie Ltd and the plaintiff and the director was a stranger to it.

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[71] K Barker, *Unreliable assumptions in the Modern Law of Negligence* (1993) 109 LQR 461, 464.
[72] n 5.
[73] n 5, 524.
[74] n 5, 518.
[75] (1974) 51 DLR (3d) 702.

> "An employee's act or omission that constitutes his employer's breach of action may also impose a liability on the employee in tort. However, this will only be so if there is breach of a duty owed (independently of the contract) by the employee to the other party. Mr McHaffie did not owe the duty to Sealand to make inquiries. That was a company responsibility. It is the failure to carry out the corporate duty imposed by contract that can attract liability to the company. The duty in negligence and the duty in contract may stand side by side but the duty in contract is not imposed upon the employee as a duty in tort.
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> "… the test is, or at least includes, whether there has been an assumption of responsibility, actual or imputed. That is an appropriate test for the personal liability of both a director and an employee".

In *Ivory* the fact that Mr Ivory had formed his company specifically to avoid liability was sufficient to show there had been no assumption of personal responsibility. There was nothing beyond "routine involvement" by Mr Ivory in this case. Lord Cooke of Thorndon later commented that "if the plaintiff had reasonably thought that it was dealing with an individual, the result might have been different".[76] This suggests that "something special" may involve factors that make it appear that the defendant was acting in his or her personal capacity. An example may be where the letter was not written on company notepaper.[77] In *Tait v Austin*[78] employee share purchase schemes were established with no registered prospectus as required by the Securities Act 1978. After the company went into receivership and liquidation the former employees sued the company and the directors. Although liability was governed by securities legislation it was noted that there was nothing special on the facts of that case that would suggest the defendant assumed a personal responsibility to the shareholders.

If Mr Ivory had conducted his business with no mention of the limited nature of the company and advertised the services as being his rather than

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[76] Lord Cooke of Thorndon, 1997 Hamlyn Lecture *"Turning Points of the Common Law"*, 18, n 51.
[77] *Livingstone v Bonifant* (1995) 7 NZCLC 260,657.
[78] (2000) 8 NZCLC 262,167.

those of the company this may have amounted to an assumption of personal liability. Although Mr Ivory provided the advice personally and engaged in extensive dealings with the complainants, the court found this had been carried out on behalf of a limited liability company and he was thus shielded from liability.

In *Ivory* it was said that in forming a one person company the director would be in the same position as if he had transferred his business to someone else and agreed to act on their behalf. Whether the principal is a company or a natural person, someone acting on his behalf may incur personal liability in tort and impose vicarious or attributed liability upon his principal. This aspect of the judgment is similar to that of *Williams* in that it clarifies that an agent may through his or her actions incur personal liability which is separate to that of the company.

1 Assumption of responsibility in the United Kingdom

An earlier assumption of responsibility case was *Fairline Shipping Corporation v Adamson* [79] where the court found the director owed the plaintiffs a duty of care despite the fact that the contract was between the plaintiffs and the company. The court cited cases where a duty had been found between employees or servants and the plaintiff, both where there had been a contract between the company and the plaintiff and in another case where there had been no contract. The court asserted that whether the defendant had stolen the plaintiff's goods or handled them negligently, if the employer was liable on the basis of respondeat superior, then the servant should also be personally liable and that this rule should be applied to all employees including directors. The finding of personal responsibility in *Fairline* was based on a letter from the director which was not on company notepaper and which the court analysed as showing that the director assumed a duty of care to the plaintiffs and regarded himself and not the company as responsible for the storage of the goods.

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[79] [1974] 2 All ER 967.

Yet a director was held not to have assumed a responsibility in *Williams v Natural Life Health Foods Ltd*[80]. There the director, Mistlin, had formed a company that was essentially a one-person operation to franchise a health food shop concept. He had been heavily involved in the preparation of materials which were given to prospective franchisees and these materials contained statements that were supported by Mistlin's knowledge and experience of the health food business. The plaintiffs relied upon these statements and opened such a shop but closed after 18 months of trading at a loss. The plaintiffs claimed against Mistlin personally and argued that the materials had included negligent misstatements as to the likely success of the health food franchises. In analysing the personal liability of the director for the financial losses caused by the negligent advice of his company, the Court of Appeal stated that the representations had been made "entirely qua Mr Mistlin and not as qua director".[81] The court found that the director had assumed responsibility because the representations were based on the experience he gained running his own health food shop prior to the incorporation of Natural Life Foods Ltd. Waite LJ argued that the duty in tort rests primarily with the company and is only secondarily imputed to its agent. He said that the liability of the company was often the only one but that in some rare circumstances the representor may be fixed with personal liability for negligent misstatement. These circumstances would only arise in special cases to avoid "setting at naught" limited liability protection.[82]

The suggestion by Waite LJ that a company is primarily liable for the torts of its agents while the agents are only secondarily liable through the company was challenged by the House of Lords. Lord Steyn recognised that once the individual's own acts are in issue, the status of the corporation as principal does not preclude the agent's primary liability for his own acts:

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[80] n 46.
[81] [1997] 1 BCLC 131 per Waite LJ.
[82] n 81, 154.

> "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 on his principal".[83]

In determining how this personal liability may be incurred, their Lordships applied the extended *Hedley Byrne* principle from *Henderson v Merrett Syndicates Ltd*.[84] *Hedley Byrne* established that a duty of care would arise where someone undertook to apply their special skill for the benefit of another person who relied upon that skill.[85] *Henderson* enlarged the possible situations where this principle would apply to include assumptions of responsibility for the provision of services as well as for statements. Further, it allowed recovery in respect of economic loss.

According to the *Henderson* test, where liability arises under a contract or in a situation "equivalent to contract" then an objective test applies as to whether responsibility should be held to have been assumed by the defendant. Thus, the state of mind of the defendant is not the focus but rather the things he or she has said or done.[86] The court will not assess internal arrangements between the director and the company but may consider the relevant contextual scene. The inquiry will always be whether the director or someone on his behalf directly or indirectly conveyed an assumption of personal responsibility to the plaintiff. Although *Hedley Byrne* was distinguished in *Ivory*, the test flowing from it was applied in *Williams* which was a situation similar to that of *Ivory*. Thus, the New Zealand courts may be persuaded by this English test for assumption of responsibility which was decided after *Ivory*.

In *White v Jones* [87] Lord Browne-Wilkinson analysed the meaning of assumption of responsibility as a conscious assumption of responsibility for the task, and not the assumption of legal liability. He stated that once

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[83] n 46, 582.
[84] [1994] 3 All ER 506.
[85] n 46, 502-503.
[86] n 46, 582.
[87] [1995] 2 AC 207.

the adviser accepted responsibility for the task, he or she created a special relationship in relation to which the law attached a duty to perform carefully.

In *Williams* because there had been no personal dealings between the plaintiffs and the defendant director the House of Lords found there had been no assumption of responsibility by the director and thus the plaintiffs had to look to the defunct company for satisfaction of their claim. The contents of the brochure and the fact that Mistlin owned and controlled the company were insufficient for finding an assumption of personal liability. In answer to the Court of Appeal's finding that the knowledge the plaintiffs relied upon was represented as being that of Mistlin personally because it was gained prior to incorporating his company, Lord Steyn observed that if a food expert with many years experience incorporates a company it is not their intention in so doing to assume personal responsibility towards their customers.

An important aspect of the test is that reliance on the assumption of personal responsibility by the defendant must be reasonable.[88] For example, in *Fashion Brokers Ltd v Clarke Hayes* [89] where reasonable reliance was considered and *Williams* applied it was held unreasonable for a solicitor to rely on a brief telephone conversation with a local council planning department.

The reliance test will involve asking not just whether the plaintiff has actually acted on the advice given and whether that outcome was reasonable but requires an analysis of the relationship of the parties. This analysis will include the defendant's possession of special skills, a conscious undertaking to use that skill on behalf of the plaintiff and knowledge by the defendant that the plaintiff will place reliance on that skill or undertaking.[90] The difficulty in determining whether an undertaking has been made is when it is implied rather than express. If Mistlin had assumed personal responsibility to the plaintiffs it would have been unclear whether they had actually relied on him

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[88] n 46, 584.
[89] [2000] Lloyd's Rep PN 398.
[90] n 70.

personally. Neyer argues that the plaintiff actually sued the wrong defendant in this case and should have sued the employee they actually dealt with and relied upon in receiving the negligent misstatements.[91]

The difficulty encountered in many cases is distinguishing facts that point to a personal assumption of responsibility from facts that suggest only performance of the company's contractual obligations. Lord Steyn stated that the liability of the company depends on a special relationship with the respondents giving rise to an assumption of responsibility. As Mistlin had been a stranger to that relationship he could not be a joint tortfeasor with the company. His Lordship stated that a finding of personal liability would require a special relationship between Mistlin and the plaintiffs and in this case there had been no such relationship.[92]

Borrowdale has analysed the decision in *Williams* as refining the assumption of responsibility test by drawing a distinction between assumption of responsibility by a company for the performance of a contract and situations where a director assumes personal responsibility for liability flowing from tortious conduct.[93] In the former case a company assumes liability for performance and for deficient performance and thus its agent cannot be liable. Thus, in the case of a contract by the company, only the company can be liable unless the director independently guarantees his or her performance.

2 Useful arguments from Canadian jurisprudence

In *London Drugs Ltd v Kuehne & Nagel Int Ltd*[94] La Forest J considered that where a tortious act has been carried out in a contractual setting, that setting should be considered in any determination of possible liability. In that case, two forklift operators had carelessly dropped and damaged a valuable transformer but a contract limited the liability of their corporate employer to $40. The Supreme Court of Canada considered the issue of

[91] n 28, 233.
[92] n 46, 585.
[93] A Borrowdale, *Directors' Liability in Tort* [1999] NZLJ 51, 52.
[94] n 47.

whether the individual employees could be held personally liable in negligence. La Forest J dissented on the duty of care issue and argued that when someone contracts with a company they do so on the basis that the company and not its employees will be liable for negligence.

A further persuasive argument by La Forest J was that, unlike their employer, the employees were not in a position to limit their liability through contract. He argued that vicarious liability should be maintained because it ensures that the party most able to pay and most able to remedy negligence is saddled with the responsibility for compensation. A further point identified by the judge was the different treatment often afforded to physical damage and economic loss cases. Although these could be approached in the same way by the judiciary, it was clear that precedent favoured plaintiffs who had suffered physical damage.

The majority nevertheless found that an employee is not relieved of liability in negligence for his or her own acts merely because of an agency relationship with an employer. This liability may extend to economic loss in certain undefined circumstances.[95] The Ontario Court of Appeal applied *London Drugs* to this effect in *Alper Development Inc v Harrowston Corp*[96] and refused to strike out claims against an employee of the defendant company who had contracted with the plaintiff for the provision of insurance services. The pleading was simply that the individual defendant had been careless. Because the proximity standard of negligence articulated in *London Drugs* was too vague the Court refused to strike out the pleadings and allowed the claims to go to trial.

In *Edgeworth Construction Ltd v ND Lea & Associates Ltd*[97] the province of British Columbia hired a firm of engineers to prepare specifications for a project being put out to tender. Both the firm and the individual engineers who had affixed their seals to the plans were later sued by the chosen contractor who claimed it had suffered economic loss because the project

[95] n 28.
[96] 1998 ACWSJ LEXIS 45823 (March 23, 1998).
[97] [1993] 3 SCR 206.

has been more costly to complete than the specifications suggested. The Supreme Court was unanimous in deciding that the engineers were not personally liable in negligent misstatement for economic loss caused to the construction firm which had relied on their carelessly prepared construction plans. This was because although the plaintiff may have relied on the defendant company, they had not relied on the individual employee. La Forest J considered that it would be unrealistic to use the fact that the engineers had affixed their seals to the relevant plans as a basis for a finding of assumption of responsibility or reliance. The judge considered that reasonableness of reliance should be based on wider contextual factors:

> "Reliance on the individual employee will rarely if ever be reasonable. In most if not all situations, reliance on an employee will not be reasonable in the absence of an *express or implied undertaking* of responsibility by the employee to the plaintiff. Mere performance of the contract [between the plaintiff and the company] by the employee, without more, is not evidence of such an undertaking."[98]

In *London Drugs* and *Edgeworth* La Forest J argued that there is a distinction between reliance on the special skill held out by the person performing the task and reliance on the particular defendant's "pocketbook" as a fund of compensation if negligence eventuates. In *London Drugs* Iacobucci J criticised this approach arguing that the duty of care analysis should focus on "the relationship between the plaintiff's position and the tortfeasor's conduct, not with the relationship between the plaintiff's position and the tortfeasor's pocketbook."
The different outcomes in the *Edgeworth* and *London Drugs* cases may appear to reflect a greater willingness to find liability in cases of physical damage caused through a careless act rather than economic loss caused through careless advice. However, in *NBD Bank v Dofasco Inc*[99] a Chief Financial Officer and a shareholder were held liable for US$1.9 million after being

[98] n 97, 313.
[99] [2000] 1 BLR (3d) 1.

found liable for negligent misstatements as to the financial stability of their company.

3 The treatment of assumption of responsibility in New Zealand

One successful tort claim which was has been analysed as an assumption of responsibility case was *Centrepac Partnership & Ors v Foreign Currency Consultants Limited & Ors.*[100] There a director of an effectively one person company had contracted on its behalf with the plaintiff's company to provide foreign currency advice and to act as their agent in foreign currency transactions. The director had gone on to commit the plaintiffs to foreign exchange contracts even though they had insisted he stay out of the market. The plaintiffs argued that the director was the sole controlling force behind the company and argued that he had procured and directed the acts. The High Court said that the director owed a duty of care in dealing with the plaintiff's foreign exchange transactions and said that it was difficult to envisage a relationship outside contract reflecting closer proximity than that between the plaintiffs and the director in this case. In emphasising that a duty of care would not be found between a company director and the company's clients in all cases, the court stated that it would depend on the facts of each case and that there must be a sufficient degree of proximity and foreseeable harm. In finding the duty the Court said they did not need to lift the corporate veil because the duty existed directly between the director and the plaintiffs. The assumption of responsibility analysis is problematic here because, although foreseeability and proximity were made out, the only clear assumption by the director was made through contract and the contract was in fact with his company. This does not exclude tortious liability on the part of the director but in this contractual context the director's acts should be analysed as acts of the company's agent in carrying out, and breaching, the contract. As principal, the company should have been primarily liable here and yet the director was found liable in negligence on his own account.

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[100] (1989) 4 NZCLC 64, 940.

In *Jagwar Holdings Ltd v Julian*[101] the High Court distinguished *Ivory* because two directors, who were found personally liable for deceit, had not made a declaration that incorporation was intended to shield them from liability as Mr Ivory had. Further, there was no contract in this case as there had been in *Ivory*. Thorp J held that it was fair that directors who took responsibility for giving company information to third parties who were being induced to take a substantial interest in that company, to personally take responsibility for their representation.[102] The different outcomes in *Jagwar* and *Ivory* may have been due to the fact that in selling the "business opportunity" the directors added their own personal endorsement to the information. The different outcomes may also have been due to the fact that deceit was involved and the courts have been more willing to find personal liability for intentional torts.

Determining that the directors of a company were joint tortfeasors with it in *Brooks v New Zealand Guardian Trust Co Ltd* the Court of Appeal stated that where directors commit a tort while acting on behalf of their company and within the scope of their authority from the company, the company will be liable as a joint tortfeasor as is the case in other cases of principal and agent.[103] The director's acts are the acts of the company itself and the personal liabilities of the directors will result in joint liability on the part of the company.

The Court distinguished their decision in *Ivory* because the relevant document had stipulated the personal responsibility of the directors. This arrangement where the directors have agreed to a manifest stipulation of their liability would seem to amount to an assumption of responsibility and "something special" as it was described in Ivory. However, in that case the issue was whether liability could also be attributed to the company as a joint tortfeasor

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[101] (1992) 6 NZCLC 68,040.
[102] n 101, 68,088.
[103] *Ferguson v Wilson* (1866) LR 2 Ch App 77, 79; *Great Eastern Railway Co v Turner* (1872) LR 8 Ch App 149, 152; *Smith v Anderson* (1880) Ch D 247, 276; *Heatons Transport (St Helens) Ltd v Transport and General Workers' Union* [1973] AC 15, 99.

so it was not determinative but the Court did accept that there was an arguable case that the directors were under a duty of care and said it should be assumed that they were.

The High Court followed *Ivory* in *Plypac Industries Limited v Marsh*[104] where the machine a company, Marshtech, had contracted to make for another company did not meet that client's specifications and was finally determined to be of no value. Once the plaintiff realised the company was unable to pay the judgment against it and was in liquidation, it sought judgment against the director personally and the insurer. The director's application to strike out proceedings brought against him was successful because a "special circumstance" as per *Ivory* was not present on the facts of this case. It was held that the company and not the director was responsible for any act or omission by the director which related to obtaining the insurance cover that was at issue. The court stated that the director only owed a duty to his company, not to the client. Consequently, there was insufficient proximity either by reason of the relationship between the parties or by the assumption of responsibility by the director towards the client to give rise to a duty of care.

Further, it was contrary to considerations of policy to find the director liable because to do so would be equivalent to placing the director in the shoes of an insurer for parties dealing with the company. It would also be contrary to the freedom of contract to enforce an obligation on a non-contracting party which the contracting parties did not provide for in the contract. It was argued that it is more necessary for tort liability to be upheld against a director when there is no contractual recourse against that party.

In considering the issue of whether the director owed a duty of care to the client, Master Venning quoted the *South Pacific Manufacturing*[105] case which favoured the *Anns* test of proximity. In *South Pacific* Richardson J stated that proximity included the question of foreseeability, the degree of analogy with

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[104] (1998) 8 NZCLC poss 261,
[105] [1992] 2 NZLR 282.

previous cases in which duties are established and an assessment of the competing moral claims. Policy considerations were, of course, the second step of this test. In this case, the issue of proximity included reasonable foreseeability of harm if care is not taken and also whether or not there has been an assumption of responsibility by the director to the plaintiff.

This wider enquiry as to whether there was a duty of care was preferred in *Banfield v Johnson* [106] where it was stated that *Ivory* should not be regarded as authority for the proposition that it will only be in cases of an assumption of responsibility that a director will be found personally liable for a tort.

A director successfully argued that the principle of assumption of responsibility should apply to liability for breach of contract as well as to tort liability in *Mahon v Crockett.* [107] Crockett claimed that Mahon, the director and controller of several companies, had agreed to pay him a percentage of the company's profits and was personally liable for those payments. The Court of Appeal held that an act by an agent of the company would not in itself give rise to personal responsibility and that an actual assumption of liability, in this case through a contract, must be proved. This was so despite the fact that the director actually told the respondent he would pay him 10% of what he made because the parties knew the director did not stand to make anything personally from the arrangement.

The court applied the decision in *Edgeworth*, which required an express or implied undertaking of responsibility by an employee, and stated that an actual assumption of liability must be proved against the director. In the case of contract to establish personal liability it must be shown that there was a contract unequivocally involving the company officer or agent who accepted personal liability apart from any liability which might apply to the corporation.

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[106] *Banfield v Johnson* (1994) 7 NZCLC 260,496.
[107] (1999) 8 NZCLC 262,043.

In *Shing v Ashcroft* [108] the Court of Appeal described a claim against a company director as an attempt to circumvent the principles of limited liability of incorporated companies. They stated that it was possible that a director may make an implied representation that he was warranting his company's ability to perform a contract but said that there was insufficient authority in which to make a decision. The court found for the director.

C *The test of control*

Factors such as proximity and control may indicate an assumption of liability.[109] In *Ivory* Hardie Boys J observed that an assumption of responsibility may be imputed where a director or employee exercises control over a particular operation or activity. Thus, sufficient control may have been present if Mr Ivory had sprayed the raspberry plants himself.

In *Morton v Douglas Homes Ltd* [110] Hardie Boys J found that directors who knew they were building flats on unsound land demonstrated the requisite degree of control because they were responsible for implementing an engineer's cautionary report and did not. The work was supervised firstly by an employee of the company and then by one of the company directors who was not a qualified builder. Hardie Boys J found that director liable for the subsidence which resulted from his ignoring the engineer's report. The other director was liable because he had taken charge of the development, knew of the problems with it, sought an engineer's advice but then did not ensure the engineer did what the company was relying on him to do. Having taken control of the building operation he either knew or should have known about these facts.

In *Morton* the court said that a director would only be personally liable for a company tort where they had expressly directed it and would only be liable to the company's client if they owed a duty of care and did not observe it. This liability arises not from the director's position but from the proximity or

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[108] [1987] 2 NZLR 154.
[109] n 106, 260, 498.
[110] [1984] 2 NZLR 543.

neighbourhood between the director and plaintiff. There was no need for them to actually oversee the work in this case so long as a careless exercise of their control caused damage to a third party. This contrasts with the need for Mr Ivory to not only oversee the work but actually do it. However, the directors in *Morton* had supervised some of the building work themselves which demonstrates a greater involvement than that of Mr Ivory.

There are problems with the test of control in the one person company context. While a director who does not personally control operations may not intend to assume personal responsibility, it does not follow that a director who does assume total control does intend to assume personal responsibility.[111] If Mr Ivory had personally sprayed the plants and was consequently held liable, this would seem to impose greater liability for a negligent action than a negligent misstatement. The test of control may be useful in analysing the part of the tortious act that can be ascribed to the director and whether he or she assumed responsibility but it is insufficient to determine whether the director is personally liable[112]. Hardie Boys J recognised this limitation in *Ivory* by stating that the control test was more likely to arise within a large company where there are clear allocations of responsibility than in a small one.

In *Callaghan v Robert Ronayne Ltd* [113] Speight J stressed that the director must be the actual tortfeasor and must have committed a tortious act rather than merely allowing it to arise by default. In that case the directors had not exercised any personal control or instruction. In *Callaghan* the court stated that the relevance of the degree of control was that it provided a test of whether a director's personal carelessness was likely to cause damage to a third party. It was this likelihood that may give rise to a duty of care, not the fact of directorship itself.

The different outcomes in the cases may be due to the fact that in *Morton* there was something, unsound land and an engineer's report, which should

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[111] A Borrowdale, *Liability of Directors in Tort – Developments in New Zealand* [1998] JBL 96, 104.

[112] n 111, 105.

[113] Unreported, Auckland, A 1112/76, 17 September 1979.

have put the directors on guard whereas *Callaghan* was a case of simple defective workmanship.

Counsel for the directors argued that this argument imposed liability on the directors by virtue of their office in a way that would not have been done had the directors been employees and that this made them vicariously liable for the negligence of their company. Hardie Boys J disagreed and pointed out that the level of control exercised by different directors may vary significantly.[114]

V THE IMPORTANCE OF CONTRACT TO THE ANALYSIS

Grantham & Rickett describe the developing assumption of responsibility tort as a voluntary, contract-like undertaking rather than an imposed duty of care.[115] They argue that Lord Steyn in *Williams* treated the assumption principle as synonymous with the duty outlined in *Hedley Byrne* which states that where "there is an assumption of responsibility in circumstances in which, but for the absence of consideration, there would be a contract."[116]

The assumption of responsibility principle has been criticised as resting on a fiction which is used to justify a conclusion that a duty of care exists.[117] In Williams this was seen as "overstated" by Lord Steyn. He argued that because contract law is limited by consideration and privity of contract, this quasi-contractual duty was necessary to "fill a gap" in the law. In *Smith v Eric S Bush* [118] Lord Griffith stated that the assumption of responsibility test was not helpful or realistic because it would rarely be undertaken expressly and it was not clear exactly what amounts to an assumption of responsibility.

The contractual analysis postulates that if tort liability arises within a contractual matrix then it must be assessed according to that and the parties planned obligations must be given pre-eminence. This involves assessing

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[114] n 110, 595.
[115] R Grantham & C Rickett, *Directors' 'Tortious' Liability: Contract, Tort or Company Law?*, (1999) 62 MLR 133.
[116] n 70, 528-529.
[117] n 46, 584.
[118] [1990] 1 AC 831.

what the parties actually contracted for. The assumption of responsibility test in *Trevor Ivory* and *Williams* is used to demonstrate that the director did not assume financial responsibility for the negligent breach of his legal duty. The only way that the director could have assumed such responsibility was through contract.

In *Ivory* the Court of Appeal is suggesting that the raspberry growers contracted to look solely to the company for indemnification occasioned by a breach of the duty of care.[119] David Goddard has pointed out that in Ivory the plaintiffs were trying to use tort to improve their contractual bargain and that there is no legal or economic justification for this. The limited recourse term is like an exclusion clause and the courts have held that claims based on concurrent liability cannot be used to get around such clauses.[120] Similarly, in *London Drugs*, Justice La Forest argued that where a plaintiff choses to deal with the company they should be aware that only the company may be liable because legislation provides for proper notice to be made of the fact of incorporation.

Where those planned obligations negate tort liability, contract "trumps" tort.[121] For example, in *Wolfe* v. *Moir* a director, Moir, advertised his company's roller skating rink as Moir's Sports Land, did not include 'Ltd' on any documentation and encouraged the public's identification of himself with the company. The Alberta Court of Appeal found in favour of a plaintiff who suffered a physical injury at the rink on the basis that corporate formalities had failed to be compiled with. Analysing this in terms of contract law, it can be argued that what the parties intended was a contract between the plaintiff and Mr Moir personally. The court found that as Mr Moir made no effort to advertise the limited nature of the business he had made a representation of unlimited liability. Thus, through the application of tort principles both the plaintiffs and the defendants are

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[119] n 28, 233.
[120] n 35, 62.
[121] n 28.

held to their original bargain. It is possible for concurrent liabilities to exist in contract and tort.[122]

VI INTENTIONAL AND NON-INTENTIONAL TORTS

There is no liability in tort unless the plaintiff proves fault on the part of the defendant either through intent or negligence. The case law has dealt differently with intentional as opposed to negligent or innocent breaches of duties. For example, in *Ivory* Cooke P observed that in the case of a non-intentional tort it would be wrong to find a director jointly liable with the company even if proximity and foreseeability were found. This contrasts with his later comment that:

> "Where damage to property or other economic loss is the basis of a claim, it may well be possible to sheet home personal responsibility for an intentional tort, such as deceit or knowing conversion. And of course if the individual defendant has placed himself in a fiduciary position towards the plaintiff, he will be personally liable for breach of his fiduciary duty."[123]

Cooke P further considered this issue in *Watson v Dolmark Industries Ltd* [124]. There the Court of Appeal found a director personally liable for procuring his company's deceit and for being involved in his company's breach of fiduciary duty. The director had made an agreement with an Australian company to make their product in New Zealand and pay them a $2 royalty for each unit produced. The director did not disclose the full number of sales made and issued false invoices. He then used the profits from these undisclosed transactions to manufacture a new product. Cooke P said that a case of personal dishonesty where the director knowingly assisted in the wrong differed from the *Ivory* situation where the owner of a one man company owed a duty of care.

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[122] *Rowe v Turner Hopkins & Partners* [1982] 1 NZLR 178, 181.
[123] n 5, 524.
[124] [1992] 3 NZLR 311.

Thus, it may be possible to argue that where a director has knowingly carried out an intentional tort causing economic loss, then this should be sufficient to establish personal liability whether or not there is an assumption of responsibility.

A director was found personally liable for inducing a breach of contract by his company in *Cook Strait Skyferry Ltd v Dennis Thompson International Ltd* [125]. There the High Court followed the *Said v Butt* line of cases which upheld the principle that where a director or servant takes part in or authorises such torts as assault, trespass to property, nuisance that director may be liable in damages as a joint participant.[126] The claim against the director was not struck out because the court held that a director could be liable for procuring a breach of contract by the company if acting outside the scope of his authority and not acting bona fide and that would depend on the actual facts of the case.

In *Mehra*[127] the Court of Appeal said that Lord Steyn's assumption of responsibility principles in *Williams* were applicable to other torts besides negligence, including deceit. In that case Mr Mehra had not led the plaintiff to believe he was assuming personal responsibility for the misrepresentations and the plaintiff believed they were dealing with the director's company. Thus, Mr Mehra was not held liable.

3 Incorporation of professional practices

In the light of the *Ivory* decision it can be seen that the personal liability of a professional person who incorporates their partnership will depend on the extent to which that person has assumed responsibility towards the plaintiff. The fact of assumption of responsibility will be unaffected by the presence or absence of incorporation and the fact that as a result of it the plaintiff will contract with the company and not with the individual. However, as stated by La Forest J above any tortious analysis will need to be considered within its

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[125] [1993] 2 NZLR 72.
[126] n 68, 506.
[127] n 63.

contractual setting. The decision in *Mahon v Crockett* would suggest that there must be assumption of responsibility with regard to a particular transaction but given Lord Devlin's comments in *Hedley Byrne* that responsibility may be undertaken either as part of a *general* relationship, such as between solicitor and client, or specifically in relation to a particular transaction,[128] it may be possible to argue that the duty is wider than this.

Cooke P's insistence that something special is required in the one person company context may suggest that something more than merely a, for example, solicitor/client relationship is required. A partner may need to take a prominent role in the business in the manner of the *Moir* case cited above or specifically authorise or instruct the carrying out of the tortious act. It should be borne in mind that *Banfield v Johnson* suggests that, at least in the case of negligence, the court may apply a test other than assumption of responsibility and in some circumstances the directs or procures test may be considered appropriate.

Tort law is concerned to ensure the quality of professional services and to allow the professions to avoid liability through incorporation may be considered undesirable.[129] In *White v Jones* [130] where a solicitor had failed to draw up a will in accordance with a client's instructions it was noted that the professional at fault could not be censured in disciplinary proceedings. In that case it was shown that the solicitor had assumed responsibility to his client and not a third party beneficiary of a will. In dissenting to the majority's decision to extend liability to include such beneficiaries, Lord Mustill said that a solicitor's knowledge that the intended beneficiary's economic well-being depended upon his careful execution of his task was quite different to the solicitor undertaking the task for the beneficiaries.[131]

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[128] n 46, 528-529.
[129] B Hepple, *Negligence, The Search for Coherence* (1997) 50 Current Legal Problems 67, 87.
[130] [1995] 2 AC 207.
[131] n 130, 279.

VII EMPLOYEE INDEMNITY

The fact of insurance is relevant to a determination of who should bear the loss in a particular case.[132] Such information arguably allows a court to place the costs of an accident on the person best able to distribute the loss and best able to avoid the accident. The Companies Act 1955 contained a broad prohibition against companies indemnifying directors against a breach of duty in relation to the company itself. This was because a director may be less conscientious if no liability could attach for a breach of duty.[133] Section 162(1) of the Companies Act 1993 restates that prohibition and extends it in two respects. An employee cannot be indemnified for any act or omission carried out in the course of their employment or for costs incurred in defending a claim. This prohibition is limited in section 162(5) which does allow indemnification in certain circumstances. However, the usefulness of this is limited in the one person company context where there will be a limit to how much insurance a director can afford.

VIII POLICY ARGUMENTS CONCERNING DIRECTOR LIABILITY

It may be argued that, unlike unsecured creditors, victims of torts are non-consensual claimants and thus it is unjust to insist they look only to the corporate entity for recourse.[134] It could also be argued that limited liability protects shareholders from the vicarious liability that tort would otherwise impose on them for the acts of their agents or employees. However, if it is remembered that the company is, in fact, only a fund and that this fund belongs to the shareholders then those members do not so easily escape liability, at least while the company is solvent. Furthermore, an agent of the corporation is not, by virtue of that fact, an agent of the director and thus there is no promise by the director to indemnify the tortfeasor agent.[135]

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[132] n 129 81.
[133] Beck and Borrowdale, *Guidebook to New Zealand Companies and Securities Law* (CCH, Auckland, 1998) 75.
[134] n 28, 196.
[135] n 28, 208.

Directors may seem an ideal target where a company has been wound up or there is a statute barring litigation against the company.[136] However, against holding directors liable it can be argued that although the separate corporate personality principle is a fiction which arguably does not sit well with one-person companies, the risk of starting up a new company is great enough without adding liability which is more appropriately apportioned to the company. A director may take on greater potential liability than would be the case in everyday life. For example, Mr Ivory had the potential to (and did) cause thousands of dollars worth of damage which would not have been possible if he had confined himself to his own garden. Such an enterprise would be too expensive to contemplate for the ordinary small operator without the protection of incorporation.

Further, a director who could be joined as a defendant may be more likely to settle rather than litigate because a court may order the one person to pay twice, once as the company and again as the director. It should be noted that the law accepts that incorporation may legitimately be used by a parent company to isolate tort liability in an operating subsidiary. [137] Similarly, the one-person company director should be able to limit liability to the company rather than "pay twice".

A rash of actions against directors may make the office less desirable and make director's insurance less available as has happened in the US.[138] The importance of directors' insurance cover was recognised in the UK by the Likierman report which recommended that it should be facilitated by legislation. If insurance is expensive it is unlikely that it will be an option for a one-person company director. Further, legislation throughout the Commonwealth provides that directors have no personal liability except in those cases expressly provided by the statute. To impose tortious liability runs counter to this pattern.

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[136] GHL Fridman, *Personal Tort Liability of Company Directors* (1992) 5 Canta L Rev 41, 57.

[137] n 93, 102.

[138] I Lupson, *The Potential Personal Liability of a Company's Directors and Officers* Int Bank L 1990 8(12), 200-202.

IX CONCLUSION

A number of tests for director liability have been identified, each one with its own particular problems for the one person company. The "direct or procure" test may make one person company directors liable in too many situations and does not fully distinguish between a corporate tort and a personal one. Similar criticisms can be made of the "control" and "makes the act his or her own" tests. The assumption of responsibility test is preferable in the one person company context because it allows the director to consciously undertake responsibility. It is submitted that this is necessary to avoid "setting at naught" the protection of incorporation in the one person company situation. There are a number of tests for assumption of responsibility and so it is possible that its adoption could engender some confusion but decisions such as *Mahon v Crockett* have been very specific as to requirements placed upon directors in this situation by the courts. It can be concluded that where a company commits a tort it will generally be considered the tort of the company and not the director unless the director takes personal responsibility for the act and that this is identified through one of these tests. In addition, if a mental element is required by the tort then this must be established.

The difficulty in this issue is that it forces a balancing act to be undertaken between tort law and company law. If the corporate veil is maintained despite a finding of a duty of care between the director and a third party too little weight is given to tort principles. Although the separate corporate personality doctrine is important, so too is the principle of holding a tortfeasor accountable for their wrong. However, as has been shown the separate corporate personality doctrine will usually prevail.