

SHORTER ARTICLES/COMMENTS

COMPANY OFFICERS AND ATTRIBUTION OF KNOWLEDGE

*El Ajou v Dollar Land Holdings Plc and Another*¹

KNOWLEDGE of officers, employees and agents of a company can be attributed to the company in one of two ways: under the “directing mind and will” approach or under the general law of agency. Under the “directing mind and will” approach, the argument is that since the company is an artificial person, the knowledge of those who manage and control it must be treated as knowledge of the company:² and those who “constitute the directing mind and will of the company” are the company for this purpose.³ This doctrine, sometimes known as the “organic theory”⁴ or the “alter ego” doctrine,⁵ has its origins in the speech of Viscount Haldane LC in *Lennards Carrying Co Ltd v Asiatic Petroleum Co Ltd*⁶ where he said:⁷

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

As for the agency approach, the law is that the knowledge of a person who acquires it as an officer of one company will not be imputed to another

¹ [1994] 2 All ER 685, (Court of Appeal), (*El Ajou*).

² *JC Houghton & Co v Nothard Lowe & Wills Ltd* [1928] AC 1, [1927] All ER Rep 97.

³ *Tesco Supermarkets Ltd v Natrass* [1971] 2 All ER 127 at 145, [1972] AC 153 at 187, (*Tesco*).

⁴ See Gower, *Principles of Modern Company Law* (5th ed, 1992), at 193-197.

⁵ *Supra*, note 1, at 695, *per* Nourse LJ. Nevertheless, see the criticism on the use of this term by Lord Reid in *Tesco*, *supra*, note 3, at 171-172.

⁶ [1915] AC 705, (*Lennards*).

⁷ *Ibid*, at 713.

company of which he is also an employee or agent, unless he owes, not only a duty to the second company to receive it, but also a duty to the first to communicate it.⁸ The position is the same even if the officer in question is a director and knowledge gained by virtue of his capacity in one company is not *prima facie* attributed to another company where he is also serving on the board of directors.⁹

These two approaches were recently reviewed in the English Court of Appeal's decision of *El Ajou*. The plaintiff's money was invested without his authority by his investment manager in fraudulent share selling schemes operated by three Canadians. The proceeds of the fraudulent share selling schemes were channelled through several jurisdictions and, eventually, some of the proceeds were invested in a London property development project (the Nine Elms project) in conjunction with the first defendant, Dollar Land Holdings plc (DLH), a property company owned by persons unconnected with the fraud.

DLH's affairs were managed by *S*, the managing director of a subsidiary of DLH, in consultation with the beneficial owners, and DLH's three directors were mere nominees who played no part in the conduct of its business. *S* had approached *F*, the chairman of DLH, who played no active part in its management, for assistance in obtaining finance for the Nine Elms project. *F* owned a company, SAFI, which acted as a fiduciary agent, and among its clients were two men who were associates of the Canadians. *F* introduced *S* to one of the Canadians, *R*, and all subsequent negotiations were conducted between *R* and *S* while *F* played no part. *F* was only involved in making all the arrangements for the receipt and disbursement of the funds provided by the Canadians which were given in two stages. At the first stage, *F* signed the letter, written entirely by *S* and addressed to *R*, setting out the terms which had been agreed between *R* and *S*. Subsequently, *F* made copies of the letter with two changes made at the request of the Canadians and dispatched the copies to the various relevant parties for the disbursement and receipt of £270,000. At the second stage, *F* signed on behalf of the holding company of DLH a loan agreement with the company owned by the Canadians in order that DLH might acquire its further fund of £1,030,000. Before the money for the second stage was paid, *F* resigned as a director of DLH. Subsequently, DLH bought out the Canadians' interest in the project. The plaintiff, when he discovered the fraud, brought proceedings against DLH to recover the money received by it from the Canadians on the ground that DLH had received the money with knowledge that it represented the proceeds of fraud. Alternatively, he sought to recover the value of the Canadians' investment, on the ground that DLH had knowledge

⁸ See *Re Hampshire Land Co* [1896] 2 Ch 743.

⁹ See *Re Fenwick Stobart & Co Ltd, Deep Sea Fishery Co's Claim* [1902] 1 Ch 507.

of the fraud before it bought the Canadians out.¹⁰

At first instance,¹¹ Millet J held that it had been proven on the facts that the funds received by DLH from the Canadians represented part of the plaintiff's money and that the plaintiff was entitled in equity to trace his money into the DLH venture.¹² Nevertheless, the plaintiff based his claim on the knowing receipt head of constructive trust¹³ and therefore it was necessary for him to prove that DLH possessed the relevant degree of knowledge that the funds it received from the Canadians represented the proceeds of fraud. The plaintiff singled out *F* and *S* as persons alleged to have possessed the necessary knowledge at the relevant time which could be attributed to the company. Millet J held on the facts before him that *F* knew that the Canadians were implicated in the fraud involving the plaintiff and that the money provided for the Nine Elms project was part of the proceeds of the fraud. However, the learned judge also found that *F* was only responsible for the formal paperwork but not for the business and that *F* took no part in the business decisions for the project in question. Further, *F*'s position as chairman and non-executive director of DLH was insufficient by itself to constitute his knowledge *ipso facto* the knowledge of DLH. As for *S*, although he was the moving force behind the Nine Elms project and his knowledge would have been that of DLH, there was no evidence that *S* knew that the Canadians were using money which they had obtained improperly, and accordingly DLH could not be taken to have such knowledge. The plaintiff therefore failed in his claim.

On appeal, the Court of Appeal reversed part of Millet J's decision. Their Lordships upheld Millet J's finding that the plaintiff's money could be traced into the venture. Since the plaintiff did not seek to upset Millet J's finding with regard to *S*, the crucial issue was whether DLH had the knowledge that the moneys received represented proceeds of the fraud by virtue of *F*'s knowledge. The Court of Appeal unanimously held, although for varying reasons, that *F*'s knowledge could be imputed to DLH by using the "directing mind and will" approach, but not by using the general law of agency.

The "Directing Mind and Will" Approach

It is established that the doctrine attributes to the company the mind and will of the natural person or persons who manage and control its actions. However, what is unclear is the criterion for an individual or individuals

¹⁰ See the report of the decision of the High Court: [1993] 3 All ER 717 at 719.

¹¹ *Ibid.*

¹² For a brief discussion of the tracing aspect of the case, see TM Yeo, "Tracing and Three-Party Restitution" [1993] SJLS 452.

¹³ *Supra*, note 1, at 688, *per* Nourse LJ.

to become responsible as the directing mind and will. Lord Haldane in *Lennards*¹⁴ distinguished between “agents” and “organs” of the company. He emphasised that the person concerned must be “somebody who is not merely an agent or servant for whom the company is liable upon the footing *respondeat superior*, but somebody for whom the company is liable because his action is the very action of the company itself.”¹⁵ The real problem comes when determining the so-called “organs” of the company. The traditional organic view¹⁶ seeks to identify the directing mind and will by looking at the constitution of the company to determine who can exercise the power in question. Therefore, only those at the top of the corporate hierarchy such as directors, superior officers or those to whom the board of directors has actually or ostensibly delegated management powers can qualify as the directing mind and will of the company. On the other hand, persons who have no managerial discretion will not be the directing mind and will of the company and their knowledge will not be imputed to the company. The decision of the Court of Appeal in *El Ajou* has apparently made some inroads into this view.

First, the majority, Nourse and Rose LJ, in agreeing with Millet J, took a robust approach and refused to confine themselves, *inter alia*, to the company’s articles of association, and service contracts in determining who represented the directing mind and will of the company. Millet J in his judgment had made a distinction between the situation where the company is a one-man company, or where all the directors possess the relevant knowledge, and the situation where the directors are merely nominees with no executive authority, or where only one of several directors has the necessary knowledge. In the latter, a non-executive director with no part to play in the company business would not, in his opinion, constitute the directing mind and will for the purpose of imputing his knowledge to the company.¹⁷ This “pragmatic approach”, as Nourse LJ called it,¹⁸ is to be welcomed as it seeks out the directing mind and will in fact rather than on paper. On the facts of *El Ajou*, although *F* was formally appointed as the chairman and director of DLH, the actual management of the company business was left to *S*, an outsider as far as the constitution of DLH was concerned, in consultation with DLH’s controlling shareholders. Furthermore, *S*, but not *F*, was directly involved in the negotiations with the Canadians leading up to the advance of the tainted funds. On this analysis, Millet J was correct to say that in relation to the Canadians’ investment

¹⁴ *Supra*, note 6.

¹⁵ *Ibid*, at 714.

¹⁶ See, eg, *Lennards*, *supra*, note 6 and *Tesco*, *supra*, note 3.

¹⁷ *Supra*, note 10, at 740-741.

¹⁸ *Supra*, note 1, at 696.

in the Nine Elms project, the knowledge of *S* was the knowledge of DLH.¹⁹

Second, the Court of Appeal went further than Millet J to hold that the directing mind and will was not necessarily that of the person or persons who had the general management and control of the company. Instead, as Nourse LJ put it, it was necessary to “identify the natural person or persons having management and control in relation to the act or omission in point.”²⁰ Using this approach, the Lord Justices narrowed the relevant facts to the very transactions by which DLH received assets representing the moneys fraudulently misapplied. They disagreed with Millet J and ruled that the responsibility for the management and control of those transactions was *not* to be determined by identifying those who were responsible for deciding that DLH would participate in the project in question and the nature and extent of that participation, far less by identifying those who were responsible for business decisions generally. Millet J’s analysis would have identified *S*, but not *F*, as the directing mind and will. Rather, the majority of the Court of Appeal thought that the crucial considerations were that *F*, but not *S*, made all the arrangements for the receipt and disbursement of the moneys concerned. *F* carried out all necessary steps that caused DLH to become involved in the project and enabled it later to acquire the assets representing the moneys fraudulently misapplied. Since *F* had taken each of the steps without the authority of a resolution of the board of DLH, he had the *de facto* management and control of the transactions. Thus, the directing mind and will of DLH at the relevant time was that of *F*.

The result reached by the majority must have come as a surprise to many. On the one hand, their Lordships’ decision to adopt a pragmatic approach in looking at the *de facto* directing mind and will of the company is plausible. On the other hand, in breaking the doctrine down to actually identifying the person(s) having management and control in relation to the particular act or omission, their Lordships were treading on dangerous ground. First, neither Nourse nor Rose LJ specified what degree of management and control with reference to the particular act was necessary before the person concerned could be said to be the directing mind and will of the company. It is worthy to note that their Lordships concluded that *F* was the directing mind and will of DLH even though it had been proven at the trial that *F*’s involvement in the receipt and disbursement of the moneys concerned was purely administrative.²¹ As pointed out by Millet J, *F* had formal authority only but no authority to commit DLH to a transaction without express instructions from *S* or the controlling shareholders. Surely to fix DLH with *F*’s state of knowledge on the sole ground that *F* formally committed

¹⁹ *Supra*, note 10, at 743.

²⁰ *Supra*, note 1, at 696.

²¹ See *supra*, note 10, at 741.

DLH to the transactions would be “elevat[ing] form over substance”,²² a step inconsistent with the pragmatic approach which their Lordships took.

Second, what kind of acts or omissions should the court consider as crucial for the purposes of identifying the directing mind and will of the company? The claim in *El Ajou* was in knowing receipt, and the Court of Appeal thought that the transactions to be considered were those by which DLH received assets representing the moneys fraudulently misapplied. It is disturbing, however, to find the court isolating the transactions involving the actual receipt and disbursement of the tainted money from the events leading up to the receipt and discounting the latter in its decision. Were the negotiations and decision for the receiving of the funds not inevitably bound together with the actual receipt itself? The Court of Appeal certainly did not think so.

Third, a natural consequence of the approach adopted by their Lordships would be that the directing mind and will of a company could be identified in relation to a particular transaction in persons other than the director or high corporate officers so long as the transaction was under the management and control of that person. This inevitably leads one to wonder whether, for the purposes of the ‘directing mind and will’ doctrine, there is any longer a real distinction to be drawn between what Denning LJ said about the “brain and nerve centre”²³ of the company, which controls what it does, and mere hands, which act in accordance with directions from the centre. If the distinction no longer exists, the whole basis of the “directing mind and will” doctrine may have to be re-examined. Even if the doctrine can exist in the form propounded by the majority in *El Ajou*, some boundaries need to be laid down as to how far the doctrine could be stretched. Cases like *Tesco*²⁴ would probably be decided differently under the transactional “directing mind and will” doctrine. However, could a bank be held liable for knowing receipt just because one of its counter-clerks has received a sum of money for deposit knowing that it is from her husband who has misappropriated funds from his company? Reading the phrase “management and control” widely, it could. However, it is submitted that the court should at least find that the person concerned possessed some form of managerial discretion in the narrow sense before holding that he or she represents the

²² *Per* Millet J, *Ibid*.

²³ In *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons Ltd* [1957] 1 QB 159 at 172, which was cited by Lord Reid with approval in *Tesco*, *supra*, note 3, at 171.

²⁴ *Supra*, note 3. In this case, the House of Lords held that the mistake of a manager in charge of one of the many supermarkets ran by Tesco Supermarkets Ltd could not be imputed to the company. Although the manager concerned was in charge of the particular supermarket, the court found that he had to obey general directions and take orders from his superiors in the company and so he did not represent the directing mind and will of the company.

directing mind and will of the company in the transaction. It is regretted that no such limit was mentioned in the judgments of *El Ajou*.

It might be argued that the majority of the Court of Appeal, in straining the “directing mind and will” doctrine, were trying to do justice to the plaintiff. However, would not a pure organic approach have given rise to the same decision in *El Ajou*? Hoffmann LJ, who delivered the minority judgment, showed that it would. He found that *F* was different from other directors, and that *F* claimed in the published accounts of DLH to be its ultimate beneficial owner. So far as the constitution of the company was concerned, by signing the funding agreement on behalf of DLH without a board resolution, *F* committed the company to the transaction as an autonomous act which the company adopted by performing the agreement. Therefore, *F* could be treated, in relation to the transaction in question, as the company’s directing mind and will.

It thus goes to show that the “pragmatic approach” of the majority was unnecessary on the facts before them. This is not to say that a more robust stand cannot be taken in future cases. It is suggested, however, that if the transactional “directing mind and will” doctrine is to be condoned, clearer guidelines on its application should be laid down.

Termination of Knowledge

Another interesting point raised by *El Ajou* concerns the termination of this knowledge. It was argued on behalf of the respondent that the plaintiff’s right to recover the money was affected by *F*’s having ceased to be a director of DLH before DLH actually received the second stage of payment and bought out the Canadians’ interest in the project. Drawing an analogy with a natural person who had genuinely forgotten about a fact which he once knew,²⁵ Millet J held that it was possible for a company to “lose its memory”, so that, where the knowledge of a director was attributed to the company but was not actually *imparted* to it, the company should not be treated as continuing to possess that knowledge after the director in question had died or left its service.

The Court of Appeal, while agreeing with the learned judge’s analysis, held that the steps which caused DLH to become involved in the project, and which enabled it later to acquire the asset representing proceeds of the fraud, were all taken during the time when *F* was still with DLH. Consequently, DLH had the requisite knowledge at the time it became involved in the project, and this knowledge was not affected by the fact

²⁵ See *supra*, note 10, at 743 where Millet J referred to Megarry VC’s speech in *Re Montagu’s Settlement Trusts* [1992] 4 All ER 308 at 329.

that *F*, the directing mind and will of the company in the transaction, took no part in the actual receipt of the asset itself.

Agency

Nourse LJ emphasised the danger of confusing the agency approach with the “directing mind and will” approach just because “a company’s directing mind and will are often the mind and will of one or more of its directors and because a director is for many purposes an agent of the company.”²⁶ The law and facts with regard to each of them are quite separate, as shown in *El Ajou* itself. The Court of Appeal held that the plaintiff’s alternative argument based on agency failed on the facts of the case. Despite the fact that their Lordships purported to follow *Re David Payne & Co Ltd, Young v David Payne & Co Ltd*,²⁷ they differed in their application of *Re David Payne* to the facts before them. Nourse LJ found that *F* acquired his knowledge of the fraudulent misapplication while he was the director of SAFI, a company which acted as the fiduciary agent for the Canadians. Although *F* owed a duty to DLH to receive it, he owed no duty to SAFI to communicate it. Rose LJ held that, *qua* agent, *F* was under no obligation to disclose his knowledge to DLH, there being no duty on DLH to inquire as to the source of the offered money. As for Hoffmann LJ, he held that while *F* *did* owe a duty, both as a broker employed by DLH to find an investor and as a chairman of the Board to disclose that the money received was the proceeds of fraud, it did not inevitably mean that he did *in fact* communicate the information. It only permitted the court to infer as a fact that he actually did so. However, on the facts, it was found that *F* did not disclose his knowledge to anyone else acting on behalf of DLH. In the absence of any duty on the part of DLH to investigate, information received by *F* otherwise than as agent could not be imputed to DLH simply because *F* owed a duty to DLH to disclose his knowledge.

Nourse LJ was of the opinion that the facts before him were indistinguishable in any material respect from those in *Re David Payne*.²⁸ However, it is submitted that *Re David Payne* actually concerned a slightly different issue. In that case, a director, *K*, induced its company (the lending company) to advance a sum of money to another company (the borrowing company) on the security of a debenture of that company for a purpose which *K* knew was outside the scope of the borrowing company’s business. No other director of the lending company, except *K*, knew how the money was intended to be applied. Subsequently, the liquidator in the winding-up of the borrowing

²⁶ *Supra*, note 1, at 695.

²⁷ [1940] 2 Ch 608, (*Re David Payne*).

²⁸ See *supra*, note 1, at 698.

company sought to impeach the debenture given by the company to the lending company on, *inter alia*, the ground that it was *ultra vires* and void and that the lending company, through *K*, knew of this fact. It was held that the lending company had no obligation to inquire to what purposes the borrowed money was going to applied, and consequently *K*, who knew that the money was going to be misappropriated by the borrowing company, was under no duty to receive or disclose such knowledge to the lending company.²⁹ The lending company was therefore not deemed to know of the improper purpose. On the facts in *El Ajou*, it is submitted that Rose LJ most accurately applied the principle established in *Re David Payne*.

Conclusion

The majority decision of *El Ajou*, although fair to the plaintiff, will undoubtedly create some unease among corporations. Under the transactional “directing mind and will” approach described by the majority, which identifies the natural person(s) having management and control in relation to the act or omission in point, it is easier to impute knowledge gained by an officer while performing transactions within his management and control to his company. In consequence, the company may be held liable in claims where knowledge plays a major role, such as claims based on the “knowing receipt” or the “knowing assistance” of constructive trust. It might be argued that this approach actually blurs the distinction between the “organs” and mere “servants” or “agents” of the company which Lord Haldane³⁰ tried to draw. This hybrid doctrine, if stretched to its furthest extent, can produce undesirable results. Although *El Ajou* may be read narrowly and confined to its facts, it indicates the potential for the approach to be carried a long way if guidelines are not laid down to check its growth. Some parameters ought to be drawn in future cases to prevent the phrase “directing mind and will” of a company from meaning nothing more than the officer-in-charge of the transaction rather than the “brain and nerve centre”³¹ which controls the company.

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²⁹ See *supra*, note 27, at 616-617 and 619.

³⁰ *Supra*, note 6.

³¹ *Per* Denning LJ, *supra*, note 23, at 172.

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