



Moore Stephens (a firm) v Stone & Rolls Ltd (in liquidation) CA [2008] EWCA Civ 644

Company cannot seek indemnity from auditors in respect of liabilities incurred by its own fraud

In a judgment delivered yesterday the Court of Appeal have overturned the first instance judgment of Langley J of 27 July 2007 by which he declined to strike out the claim of Stone & Rolls Ltd against its auditors.

The Facts

The essence of the claim brought by Stone & Rolls Ltd (“the Company”) against its auditors Moore Stephens (“the Firm”) was that the Firm had negligently failed in the course of its various audits to detect the fraudulent behaviour of Mr Zvonko Stojevic. Mr Stojevic, the sole directing mind and will of the Company, had used the Company to commit a letter-of-credit fraud against banks. The fraud consisted of the presentation by the Company of false documents to the banks, the receipt of funds by the Company and the payment away of those funds to other parties.

The Issues at First Instance

The Company’s Liquidators brought a claim against the Firm for damages to compensate it for losses it is said to have suffered as a result of the Firm’s negligence in failing to detect Mr Stojevic’s fraud during the conduct of its audits. The claim was in the region of \$174 million. In its defence the Firm submitted that the company was never in any real sense deprived of its money by the fraud but was simply used as a conduit for the passage of funds and that the Company’s claim involved it seeking to rely upon and recover a loss caused by its own fraud – as such, on the basis of the maxim that a party cannot claim losses suffered as a result of their own criminal conduct, the claim is doomed to failure and should be struck out.. The Company, in turn, submitted that Mr Stojevic’s dishonesty was not to be attributed to the Company, which was not, therefore, relying upon its own fraudulent conduct in bringing the claim.

Judgment at First Instance

At first instance, Langley J held that had the claim been pursued by Mr Stojevic it would have been defeated by the operation of the *ex turpi causa* principle (no action will arise out of an illegal or immoral act); there was no compelling reason why a corporation should not be subject to the same considerations where the wrongdoing was attributable to the corporation; as Mr Stojevic was the directing mind and will of the company, his knowledge and wrongdoing could be attributed to the Company; however, the conscience of the ordinary citizen would not find the pursuit of the claim so repugnant that it ought to be prevented “by use of the unforgiving and uncompromising operation of the *ex turpi maxim*” as there was no principled basis on which the defrauded creditors of a company should be in a worse position than those whose debts arose in the ordinary course of business. He therefore declined to strike out the claim.

The Appeal

On appeal, two submissions on the law were raised by the Company as follows: (1) that while not questioning the general operation of the *ex turpi causa* principle, the principle cannot prevent the Company from suing for recovery in respect of its own losses caused by the individual who was its directing mind and will in relation to the frauds. This was on the basis that the Company itself was said to be a victim of the frauds and should not have any knowledge of them attributed to it; and (2) that the principle can in any event provide no defence to the Firm when the detection of dishonesty in the operation of the Company’s affairs was “the very thing” that the Firm, as auditors, was retained to do. The Firm submitted that both propositions were wrong.

Judgment of the Court of Appeal

■ Ex Turpi causa

The Court of Appeal noted that there was no dispute on the facts of this case that the Company’s claim relied upon, was based substantially on and was inextricably linked with the fraud that was perpetrated on the banks. In such circumstances, the victims of the fraud were the banks. There was no prospect of establishing at trial that the Company was the victim of the fraud.

■ Attribution

It followed that the next question was whether in these circumstances Mr Stojevic’s fraud could properly be attributed to the Company. On this issue, the Court of Appeal held that, where Mr Stojevic “owned the Company and controlled it in its every relevant act”, his dishonest intention could properly be attributed to the Company which could be as much a wrongdoer as the individual involved. In such circumstances, the claim by the Company could be met by the plea of *ex turpi causa* which would afford a complete defence to the claim, subject only to consideration of the Company’s second submission that this principle could not provide a complete defence when the detection of dishonesty was “the very thing” that the Firm was retained to do.

■ "The Very Thing"

In the Court of Appeal’s view “the very thing” argument did not override the *ex turpi causa* defence. That defence where it applies is an “unforgiving and uncompromising” one. “The very thing” concept arising in *Reeves* (HL [2000] AC 360) is a concept that is about causation. It does not provide authority for the proposition that if “the very thing” from which the defendant owed a duty to save the claimant harmless is, or includes, the commission of a criminal offence,

the public policy defence based on the ex turpi causa principle will be overridden so as to enable the bringing of a claim that relies on the claimant's illegality.

Finally, in the words of Lord Justice Mummery, "it is contrary to all common sense to uphold a claim that would confer direct or indirect benefits on the corporate vehicle, which was used to commit the fraud and was not the victim of it, and the fraudulent driver of the fraudulent vehicle."

Implications

This case will obviously be of interest to those involved with claims involving companies controlled by a dishonest directing mind. Its application is clearly fact sensitive and will depend on the degree to which, in any given case, it is established that the person responsible for the perpetrated fraud was the "sole directing mind and will of the Company involved". It was common ground in this case that the Company was Mr Stojevic's company. Indeed, it was the essence of the Company's claim that it was, for practical purposes, a "one man company". The case does not interfere with the principles of attribution derived from Hampshire Land whereby the intention of a dishonest agent who is not the directing mind and will of a company will not generally be attributed to it for the purposes of claims against others. It is not yet known whether leave to appeal will be sought.

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