DIRECTORS' TORTIOUS LIABILITY: A Study of Case in Hong Kong and England

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Abstract

The study investigates both of the Identification Approach and the Agency Approach, where director’s personal tortious liability is explained by the director is the company itself or simply an agent of the company. The research will primarily cover the jurisdiction of England.

The paper aims to i) review the modern development of director’s personal tortious liability for acts committed in the course of operating the company; ii) examine two main conflicting approaches, the Agency Approach and the Identification Approach, in relation to director’s tortious liability; iii) evaluate the two aforementioned models in relation to the modern society with the reference to recent case authorities. In conclusion, the authors explicitly support the proposition that the director’s personal liability in tort should be determined in accordance with the general principles of tort law based on the agency approach rather than any special principles shaped by company law doctrines based on the identification approach which will limited the director’s liability.

Key words: Directors’ Tort; Identification Approach; Agency Approach; Assumption of Personal Responsibility

Introduction

Under the current company principles limited liability, shareholders’ liability is limited by shares, which means shareholders are only liable to the extent of any unpaid capital on the shares they have subscribed.1 Besides, it has been long established since Salomon v. Salomon2 that a company is at law a different person from its directors and shareholders, which is called the spate legal entity principle. Therefore, a company can be liable for its own acts, including torts, according to its nature3. These two basic principles together form the basis of the modern company law, and even the financial system of the world. On the other hand, the well-established tort law principles require the wrongdoer to compensate for his or her misconduct in order to do justice. The question arises on whether the company or its director should be treated as the wrongdoer when the tort is done by the company’s director in the course of operating the company.

There two main approaches in explaining director’s tortious liability: the Agency Approach and the Identification Approach. The Identification Approach suggests that, based on the limited liability and separate legal entities principle, the director should be treated as acting as the company itself when he or she is acting in the course of the company’s business. However, the Agency Approach alleged that the director is only an agent of the company, which is a separate entity, and therefore should be personally liable for his
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or her own wrongful acts. These two conflicting approaches reflect the fundamental conflicts between company law and tort law in deciding director’s tortious liability. On one hand, tort law has long accepted that an individual is responsible for his or her own tortious acts; on the other hand, making directors liable in these circumstances would arguably damage the doctrine of separate entity and limited liability which are the foundation of company law.

Recently, various courts in different jurisdictions have considered the issue of director’s personal tortious liability and the courts have expressed their opinions to have considered the issue of director’s personal tortious liability. The courts have emphasised the need for the basic company principles of limited liability and separate legal entity to have primacy over tort law principles in shielding directors from the personal liability that might otherwise arise from a simple application of tort law. At the same time, they also recognised that there is a need to prevent company law doctrines from being used in a way that overrides the policy objectives of tort law in preventing tortious conduct and in compensating tort victims. The courts tried to balance these two considerations and set out a general principle for this type of cases. However, since these principles often contradict with each other and almost all of the decisions made by various courts have been heavily criticised by different academic commentators, it seems that there is still no conclusive and widely accepted principle has been laid down up to now.

Two Main Approaches in Director’s Tortious Liability

1. The Agency Approach

The Agency Approach recognises a director as the agent of the company and their liability would be assessed accordingly. Under the Agency Approach, because the director is viewed as an agent of the company, following agency law principles, the director will be normally liable for all of the tortious acts committed by him or her. In addition, the company as principal would also be vicariously liable for the tort committed by their director who is its agent. This approach can be seen as a creature of the tort law principle. In essence, the Agency Approach means the court, in deciding director’s liability in tort, should directly adopt the well-developed tort law principle for individuals to the companies and its directors without any alteration made by company law principles.

Compared to the Identification Approach which will be discussed later, the Agency Approach seems to be a more preferable one in the recent case authorities. In the recently case authority Williams v. Natural Life Ltd, for instance, the House of Lords adopted the Agency Approach. In Williams, the judgment mainly concerns how to adopt the Hedley Byrne principle to the current case, which is obvious a tort law principle, rather than which approach, the Agency or Identification Approach, is more suitable. Even though there is not much discussion on this topic, the attitude of Lord Steyn, who delivered the judgement for the House, to this question is very obvious from his Lordship’s words that “For the present purpose, his (a director’s) position is the same as if he had sold his business to another individual and agreed to act on his behalf. Thus the issue in this case is not peculiar to companies. Whether the principal is a company or a natural person, someone acting on his behalf may incur personal liability in torts as well as imposing vicarious or attributed liability upon his principal.” Therefore, in the eyes of his Lordship, the company should be treated as the principal of the director.

2. The Identification Approach

The Identification Approach identifies a director as the company itself; therefore, under this approach, it is logical to say that the director’s act will also be recognised as the company’s act. Based on this approach, since it is the company, not the director who has committed the tort, some courts have consequentially concluded that such identification would normally exempt the director from personal liability and the company, instead of the director himself, should be liable for tortious acts committed by its director.

There are lots of cases authorities which adopts the Identification Approach ever since the 1980s, but the leading case Trevor Ivory Ltd v Anderson decided by the Court of Appeal of New Zealand would certainly be the most significant one among all of those cases. This case will be discussed in detail in the following part of this paper, for the purpose of this part; it must note that the Court of Appeal of New Zealand rejected the Agency Approach in their judgment, as Hardie Boys J stated in the judgment that “To describe a director as the agent of the company can be deceptive.” Instead of the Agency Approach, Hardie Boys J found that Lord Reid’s judgment in Tesco Supermarkets Ltd v. Nattrass, in which Lord Reid noted that “(a corporation) must act through living persons…then the person who acts…is acting as the company and his mind which directs his act is the mind of the company” would be more appropriate in this case. By adopting Lord Reid’s idea in Tesco Supermarkets Ltd to the case, Hardie Boys J. concluded that “…in appropriate circumstances they (directors) are to be identified with the company itself, so that their acts are in truth the company’s acts. Indeed I consider that the nature of corporate
personality requires that this identification normally be the basic premise...” Although the Honourable Judge agreed that personal liability can still be imposed on a director based on the “assumption of personal liability test”, it can rightly be said that in most circumstances the directors can escape their liability under this test.

**Directors’ Personal Liability in Negligence**

1. **A Brief Discussion on the Leading Case Authorities of Director’s Tortious Liability**

Although there have been a large number of cases which concerns the issue of director’s personal liability in tort, this paper will mainly focus on four of them, namely *Trevor Ivory Ltd v. Anderson*16, *Williams v. Natural Life Ltd.* (Court of Appeal)19, *Williams v. Natural Life Ltd.* (House of Lords)20 and *MCA Records v. Charly Records*21. These four cases are the leading judgments in this area of law thus they are likely to be adopted in Hong Kong by the Hong Kong courts. Furthermore, the courts held very different views in these cases and they have expressed their reasons in detail for adopting such views. Therefore, a discussion on these leading cases will be valuable for the better understanding of the arguments in the later part of this paper.

1.1 *Trevor Ivory Ltd v. Anderson*

*Trevor Ivory* decided by the Court of Appeal of New Zealand is one of the most important case authorities of the director’s personal liability in tort and it has been considered by various courts in the later cases related to director’s tortious liability. The facts of *Trevor Ivory* can be summarised as follows: the appellant, Trevor Ivory, was the major shareholder and managing director of a Trevor Ivory Limited. The Trevor Ivory Limited was in fact a so call “one man company” which provides agricultural and horticultural supplies and advisory service. The respondents were the owners of an orchard on which there was a raspberry plantation. An oral contract was entered into between the parties in 1983, in which the appellant agreed to provide consultation service related to the raspberry in consideration of an annual fee of $5,000. In fear of the growth of couch grass, the respondents sought advice from the appellant under the contract. The respondents recommended an herbicide called “Roundup”. In reliance on the advice, the respondents directed their employees to spray the Roundup in the whole orchard under the appellant’s instruction written in a letter. However, Roundup is so powerful that it will also affect the raspberry plants. In the later spring it was discovered that the crop had been seriously affected and ultimately the raspberries had to be dug out. The respondents sued the Trevor Ivory Limited and the appellant in both breach of contract and the tort of negligence. In the first instance court, the trail Judge allowed all the respondents’ claims in both contract and tort and the appellant was held personally liable for the negligence. The Trevor Ivory Limited and the appellant appealed against the trail Judge’s finding of negligence and the appellant’s personal liability. However, the Court of Appeal of New Zealand dismissed the appeal on all matters except the finding as to the personal liability of the appellant.

In considering the appellant’s personal liability, as aforesaid, the Court of Appeal of New Zealand adopted the identification approach. In addition with Hardie Boys J, Cooke P also stated that: “…in *Tesco Supermarket Ltd. v. Nattrass*22, that a person may be identified with a corporation so as to be its embodiment or directing mind and will, not merely its servant...The present is a question of the third party type, and it seems to be the *Tesco* doctrine assists in deciding it...In my view the realistic interpretation is simply that Mr. Ivory was identifying himself with his company, as if he had read the *Tesco* case.23

Although not expressly, it seems that the Court choose the Identification Approach because of the company law doctrine of limited liability. For example, Cooke P has stated in his conclusion that “I commit myself to the opinion that, when he formed his company, Mr Ivory made it plain to all the world that limited liability was intended.”24 The use of corporate veil in this situation, in McGechan J’s opinion, is to avoid the high risk in business under the protection of limited liability.25 Hence, it can be rightly to say, in *Trevor Ivory*, the Court’s opinion is that limited liability in relation to economic loss and duties of care were intended as common facts of business.26 Since limited liability is intended, the director should not be held personally liable for his or her acts in the course of business unless in some exceptional circumstances.

The issue then became in what circumstances the director would be held personally liable. The “assumption of responsibility” test was therefore created. The test is, in Hardie Boys J’s words, “whether there has been an assumption of responsibility, actual or imputed.”27 According to this test, the directors would be held personally liable only if they assumed the personal responsibility by something “sufficiently special”; however, Cooke P also pointed out that “to attempt to define in advance what might be sufficiently special would be a contradiction in terms.”28 The Court has also rejected to consider the issue within the tort principle in *Hedley Byrne*29 in this case because *Hedley Byrne* was not concerned with whether directors or shareholders or employees of the company assumed any such personal duty30 and therefore “it may indeed be drawing the long bow to apply a *Hedley Byrne* approach so as to impose
personal liability upon the managing director... Finally, the Court has concluded that the appellant did not assume personal liability in this case, or even if he did, this case is not so special that can justify imposing personal liability on the appellant. Thus, the appeal was allowed and the appellant was held not personally liable for the tort.  

1.2 Williams v. Natural Life Ltd. (Court of Appeal and House of Lords)

Some years after the decision of Trevor Ivory, the Courts of United Kingdom was given a chance to consider the same issue in Williams. The facts of Williams are very similar to Trevor Ivory: The plaintiffs decided to run a health food shop and approached the first defendant company to get advice on the business. The said company was established by the second defendant, Mr. Mistlin, who is also the managing director of the defendant company. In the brochure sent by the defendant company to the plaintiff, Mr. Mistlin and Mr. Padwick were described as having the experience and expertise necessary to provide properly reasoned advice on all matters necessary to the establishment of a viable franchise business on behalf of the defendant company. In reliance of the defendant company’s words, the plaintiff signed a franchise agreement with the defendant company for a ten-year term. Financial projections prepared by Mr. Padwick were given to the plaintiffs and these projections were later been describe as “too optimistic”. Followed the projections, the plaintiff opened their shop but later they discovered that the projections had been substantially overstated. Due to the negligent advice given by the defendant company, the plaintiff suffered substantial loss and the sued the defendant company claiming damages in respect of the loss they had loss as a result of the negligent financial projections and advice. Since the defendant company was winding up at that time, the plaintiffs joined Mr. Mistlin as the second defendant; after the defendant company was dissolved, the plaintiffs pursued their claim against Mr. Mistlin alone.

Even though this case has been appealed to the House of Lord, the decision made by the Court of Appeal of England is still a valuable one and worth discussing. The Court of Appeal agreed with the New Zealand Appellant Judges’ idea in Trevor Ivory that the director should be protected by doctrine of limited liability. The Court did not expressly agree with the identification Approach, however, it is obvious that the Identification Approach was more preferable in its eyes because holding the director be protected by the doctrine of limited liability is in its essence contradict with the Agency Approach. Although protected by the doctrine of limited liability, the Court also agreed that in some rarely circumstances the director should still be held personally liable, otherwise the “representees could set at naught the protection which limited liability is designed to confer on those who incorporate their business activities.” The situation in which a director will be held personally liable is, in the words of Hirst LJ, that “a company director is only to be held personally liable for the company’s negligent misstatements if the plaintiffs can establish some special circumstances setting the case apart from the ordinary...” This test is very similar to the “assumption of responsibility” test in the Trevor Ivory case and even Hirst LJ agreed that “…it is indeed in accordance with the principle laid down in the Trevor Ivory case.” Applying the test to the present case, their Lordships concluded that since the advice given by Mr. Mistlin on the personal experience gained before the company was founded, there was sufficient special circumstance to held Mr. Mistlin personally liable. Though Mr. Mistlin was held liable, the Court did emphasise the directors were generally protected by the doctrine of limited liability by making a clarification that “…I have reached this conclusion solely on the particular facts of this case, and I do not think there is any risk of compromising the general concept of limited liability.

The Court of Appeal of England’s decision in Williams, however, was reversed unanimously by the House of Lords. As aforementioned, the House of Lords recognized directors as the agents of a company. Lord Steyn did not agreed with the idea in Trevor Ivory that imposing personal liability of directors would damage doctrine of limited liability because the doctrine of limited liability is only concerned with the limited liability of shareholders. What matters in this case, in Lord Steyn’s words, is “a company is a separate entity, distinct from its directors, savants or other agents.” Lord Steyn considered this claim was a claim for pure economic loss in tort, hence, it should be governed principle set out by Lord Goff in Henderson v. Merrett Syndicates Ltd. which was an extended Hedley Byrne principle. In His Lordship’s idea, directors will not be liable for negligent advice given in the course of operating their company, not because they occupy a unique position or because the rules of company law protect them, but simply because the crucial elements of the relevant tort are not made out. To establish a duty of care under the extended Hedley Byrne principle, the plaintiff must prove the defendant has assumed personal responsibility, and he had reasonably relied on the defendant’s acts. Though “assumption of responsibility” was again used by the House of Lords, it has a different meaning from the same phrase used in the Trevor Ivory and the Court of Appeal of England in the same case. In Trevor Ivory, the “assumption of responsibility” was used to protect the directors under the doctrine of limited liability, however, in Williams, the House of Lords used it simply because it was required...
by the well-established tort law principle. After a serious consideration of the facts under the extended Hedley Byrne doctrine, the claim was defeated since their Lordships found that the defendant has never assumed personal responsibility in this case, even if he did, the claimant could not reasonably rely on the assumption made by the defendant. 44 The Court of First Instance of Hong Kong followed Williams in Wycombe Investment Ltd. v. Edwin Leong Siu Hung45 which is a case related to director’s personal tortious liability. Besides, it was approved both by Court of Final Appeal of Hong Kong in Yiu Chown Leung v. Chow Wai Lam William46 and CAHK in Leung Yiu Chown & Others v. Chow Wai Lam & Others47 and DC in Thomas Bovet v Selpro Tactical Ltd48.

1.3 MCA Records v. Charly Records

In Williams, the House of Lords has expressed that this case was not related to joint tortfeasor since the plaintiffs had abandoned this cause of action in the Court of Appeal and, even if they had not, it would nevertheless be dismissed because to allow it “would expose directors, officers and employees of companies carrying on business as providers of services to a plethora of new tort claims.” It was not so clear that whether the Williams was applicable to joint tortfeasor until the Court of Appeal of England delivered its judgment in MCA Records v. Charly Records49 few years later.

This case was about copyright. The defendant company, Charly Records, was a company produced re-issues of recordings. The fourth defendant was a former director of CRL, a subsidiary company of the Charly Records, and after resigning his directorship, he remained as an employee of the company. Charly Records had brought the copyrights of some recordings from a person whom claimed to be the owner of them and these records were produced by the company. However, the copyrights were in fact own by the plaintiff company and it had never authorised the said person to sell them. The plaintiffs therefore start proceedings against the Charly Records for breach of copy right. Additionally, the plaintiffs also asserted that the fourth defendant, a former director of a subsidiary company of Charly Records, had personally authorised, procured and directed and was personally liable for the company’s acts as a joint tortfeasor. The fourth defendant was held liable in the first instance, and he appealed to the Court of Appeal of England.

In appeal, the fourth defendant alleged the trial judge apply wrong principle of law in deciding his liability in tort. Williams was submitted by the fourth defendant and it was argued that this should be the correct approach in relation to his case. 50 However, the Court of Appeal of England rejected this argument.

Chadwick LJ had cited Lord Steyn’s words aforementioned in page 15 and held that “In my view it is impossible to read into that passage a general proposition that a director can never be liable as a joint tortfeasor with the company. The basis of Lord Steyn’s rejection of joint liability in that case, as it seems to me, is that Mr. Mistlin could not himself be liable to the plaintiffs, whether jointly or severally, because he was not party to the special relationship which had given rise to an assumption of responsibility and upon which, alone, liability could be founded.” 51 Therefore, Williams was distinguished by the Court. In the case, the Court expressly accepted the view that directors can be liable pursuant to ordinary principles of joint tortfeasance based on the general tests of secondary liability that the director can be liable where he intended, procured and shared a common design that the tortious conduct should take place. 52 Based on the principle, the Court concluded that a director, acting no more than carry out his constitutional role in the company would not be held liable as joint tortfeasor. However, the Court held that in the present case, the fourth defendant had acted beyond his constitutional role and hence should be held liable. Again, the Agency Approach is more favourable to the Court in this case because they treat the directors the same as other people of the company. Additionally, this case has now become part of the Hong Kong law because it has already been adopted by the Court of First Instance of Hong Kong in Yakult Honsha v. Yakudo53 and Tai Shing v. Maersk54.

2. The Main Arguments of the Identification Approach

By adopting the Agency Approach, both Williams (House of Lords) and MCA Records been heavily criticized by some jurists who in favour of company law. In their opinion, the assumption of responsibility test in Trevor Ivory in which the identification approach was adopted is more preferable. Several reasons have been raised by these jurists.

2.1 The Purpose of Company Law

Some scholars argued that the primary purpose of company law is to modify the way general principles of law, such as contract and tort, apply to individuals when the corporate entity is interposed.55 By applying the separate legal entity principle into tort law, the director and his company should be treated as one in the course of operating the company. The Trevor Ivory and Williams (Court of Appeal) cases in which the director was held to be the company itself are used to support their arguments and alleged to be the correct approach. Hence, the House of Lords was wrong to simply adopt
the extended *Hedley Byrne* principle without the modification by company law. R. Grantham even alleged that “to refuse to accept that these general principles are modified is not only to deny the primacy inherent in the rules of company law, but in a sense it is to deny the company’s very existence.”56 It is also argued that the separate entity doctrine should lead to directors escaping tortious liability when acting as the company on the grounds that, to allow otherwise would be “to deny the company any meaningful existence and to frustrate the entire purposes for which the State recognised the corporate form”.57 Furthermore, these jurists insist that there is a hierarchy of principles between company law principles and other general laws principles, such as tort law, and company law is in the top of the said hierarchy of laws; therefore, when there is a conflict, company law principles should prevail.58 Such primacy is inherent in the very nature of company law.59 As aforementioned, the essential issue in relation to director’s tortious liability is the conflict between company law doctrine and tort law principle. According to this theory, the company law principles of separate legal entity and limited liability should prevail in these kind of cases, and the consequence of giving tort law precedence would be effectively to strip away the protection and purpose of a limited liability company. Thus, in the context of liability of directors for tortious conduct, the interposition of the rules of company law would entail that although a director may in fact have physically committed the tortious action, the director may not be identified as the tortfeasor.61

### 2.2 The Extension of the Doctrine of Limited Liability

It is suggested that the doctrine of limited liability should also be extended to the directors in order to maximize the utility of the corporate form and significantly increase the creation of social wealth.62 By failing to properly consider the company law principles and holding that directors are treated as agents in the tort in *Williams*, these jurists criticized that the House of Lords has defeated the main purpose of company law. Although one of the main functions of limited liability is to protect shareholders, not directors, but there is no reason why a century after the principle of separate corporate personality established in *Salomon*, the principle should not now be invoked as a matter of policy to protect directors as well as shareholder.63 The individuals in the business of giving advice should be able to rely on the protection of the limited liability company in the same way other people setting up business can. Especially in closely held companies, exposing directors to personal liability for all torts negates the purpose of carrying on business using a limited liability company.64 This is because the directors of closely held companies are almost always shareholders in the companies as well.65 In order to promote business efficiency, the company law should ensure those individuals are protected from being imposed personal liability for the responsibility, and the legal consequence of the tortious conduct or contractual undertakings.66 Therefore, the House of Lords’ decision in *Williams* will significantly extended the director’s tortious liability in relation to torts committed by the company which erodes the company principles and thereby under mines the business efficiency of the society.67 In addition, it has also been submitted that the separate entity doctrine that a company is a legal entity with its rights and liabilities different from its shareholders and directors forms the very basis of limited liability.68 Under separate entity doctrine, immunity of tortious liability should be given to directors. Therefore, limited liability is enjoyed by both directors and shareholders in tort or at least should be extended to directors.

#### 2.3 Other Considerations

Finally, it is also submitted that apart from running against the company law principles of separate legal entity and limited liability, imposing personal duty of care on director is considered to be unfair, unjust, or even unreasonable if tort committed by the company alone is to be diverted to its directors who are merely the instrumentality used by the company.69 The imposition of tortious liability on directors in the course of operating the company would lead them to adopt a sub-optimal strategy in management, namely to ‘under-invest’ in risky ventures that might entail personal liability.70 As a result of that, the directors of the companies will be reluctantly to make investment on some hazardous but important industries, such as mining, in order to avoid their potential tortious liabilities.71 The essential policy behind limited liability is generally accepted to be the promotion of investment in business and the encouragement of entrepreneurship.72 Besides, limited liability can also be justified from the economic perspective on the basis of its efficiency and the availability of limited liability on directors would reduce risk aversion, providing incentive to venture.73 Therefore, although the principle of limited liability is not directly related to the directors’ liability,74 the consequence of imposing personal tortious liability on directors will defeat the policy goals of limited liability, especially when the director is the major or only shareholder of the company.75 Furthermore, the replacement of the *status quo* principle is likely to cause substantial influence on rules that have been modelled upon the principle, a matter that would cause profound and far-reaching influence on the company law.76
3. The Flaws of Identification Approach and Policy Considerations in Favour of Agency Approach

Other jurists, however, argued that the courts of England have adopted the right approach, namely the Agency Approach, in both cases of Williams and the MCA Records. A Large number of reasons have been given by these scholars. Due to the length of this paper, only the most important ones will be summarised and discussed in the following.

3.1 Imposing Personal Liability on Directors Will Not Affect the Company Law Doctrines

First of all, the jurists pointed out that the Agency Approach adopted by Williams and MCA Records will not affect the company law basis. As aforesaid, Lord Steyn in his judgment has made it clear the doctrine of limited liability is only related to shareholders, not to the director; therefore, the directors’ personal liability in tort is totally unrelated to this doctrine.\(^7\) Imposing personal tortious liability to the director will not damage the doctrine of limited liability in any event.

It is also a misconception that tortious liability of directors will damage the doctrine of separate legal entity. Lord Steyn in Williams has commented on this misconception that “what matters is not the liability of the shareholders of a company is limited, but that a company is separate entity, distinct from its directors, servants or other agents...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 liability or attributed liability upon his principal.”\(^7\)

Although Lord Haffmann has once commented in Meridian Global Unds Management Asia Ltd v. Securities Commission in some rare situations the some acts can be recognised as made by the company itself and the courts should follow the following instructions in deciding the question.\(^7\) First of all, his Lordship pointed out that whether the acts can be recognised as acts of the company depends on the primary rules of attribution, as set out in the corporate constitution or implied by company law. Secondly, acts can be attributed to the company pursuant to general rules of attribution under the law, such as principles of vicarious liability and agency. Thirdly, there will be situations where the above principles of attribution might not be appropriate in determining how a particular law applies to the company, and in such situations it may be necessary for the court to fashion a special rule of attribution to determine whether the act or state of mind of a particular individual should be attributed to the company for the purpose of that particular law.\(^8\) Some scholar argued that, where the situation only relates to the application of the second of the above category, there can be no rooms for the operation of the concept of a person acting as a corporate organ.\(^9\)

While it is generally accepted that the broad of directors of the company can be recognised as the company itself, it is further argued that when individuals are delegated authority from the board under the corporate constitution to deal with the outside world in the business of the company, they should be prima facie be regard as the agent of the company because this situation only relates to the application of the second category of Lord Haffmann’s direction.\(^1\) Besides, the scholars pointed out that, even if there is a hierarchy of laws that the company law principles should be prevail, the individuals only commit the tort thorough conducts carried out pursuant to such delegated authority, then the ordinary principles of tort law could be more relevant principles in determining liabilities of the company as well as the individual. Therefore, the arguments that the directors are acting as the company itself is irrelevant here, and the identification theory cannot be relied upon to override the ordinary application of tort law principles in this situation.\(^3\) Since it is clear now that personal liability of a director in tort is not related to company law principles, there can be see no reason why the company law principles should apply in tort, and tortious liability of a director can be determined without in any way derogating from the hallowed principles of company law.\(^4\)

3.2 The Principle of Limited Liability Should Not Be Extended

Most of the scholars disagreed with the idea that the doctrine of limited liability should be extended to the directors. Under the general agency and tort law principles, the agents and employees of a company cannot escape personal liability for torts committed by them,\(^5\) and the company may only vicarious liability for the said tort under the principle of vicarious liability.\(^6\) By extending this doctrine, the directors can escape their personal tortious liability while the agents or employees will still be personally liable. However, the reasons mentioned above cannot justify the fact that by extending the limited liability principle to the directors the law will place more protection to one class of people in the company, namely the directors, than the other classes.\(^7\) Furthermore, comparing to the employees and agents of a company, the directors are has more power in the management of the company, in most situations the employees and agents will only follow the directions given by the directors. Therefore, if the directors are protected from personal liability from the acts committed by themselves while the employees and agents has to bear the consequence by themselves for following their misdirection, it will
create a very unconscionable and unjust situation. As Slade LJ stated in *C. Evans & Sons Ltd v. Spritebrand Ltd.*, “it would offend common sense if, on the hypothetical facts postulated, the law of tort were to treat the director of the company any more kindly than the savant who took his orders from the directors.”

Additionally, if the court allows extending the limitation on liability to the directors, it will make that directors act carelessly in the course of business afterwards because the extension of limited liability on directors would disrupt the equilibrium between risk and responsibility. The imposition of personal liability on director plays a pragmatic constrain on shareholders who push for high risk investment. The financial crisis happened this year is a good recent example. Before the financial crisis, the personal liability of the directors in banks and investment companies was protection by contract; they can earn a huge amount of bonus in accordance with the contract from the investment they made. Therefore, they act negligently in the companies’ investments in order to gain more bonuses for themselves and subsequently create the crisis. However, none of these directors who made lots of negligent investments is required to be responsible for the loss cost, not only to the shareholders but also to the whole society. Hence, it is obviously that, if all the directors are protected from personal tortious liability, the directors will act even more negligently in the course of managing the company since greed is such a human nature. It is not surprising that another financial crisis will be caused and this one will certainly be even more serious than all previous ones, including the Great Depression. The view that extending limited liability to directors will increase the society wealth is totally wrong and imaginative. In fact, the wealth it can create, if any, is only an illusion while its potential society costs can be extremely high. Therefore, the imposition of tortious liability on director would guarantee the quality required of director, thereby reducing the chance of loss suffered by investors. Apart from such, the right to recover against negligent director also provides an alternate route for recovery in cases where the employer has insufficient insurance or assets, which is frequently found in the case of one-person company. In summary, the idea that limited liability should be extended to the directors is totally wrong and should not be even considered.

3.3 Policy Considerations for Director’s Personal Liability

Lastly, it is also alleged that, there is no actual conflict between the tort law principles and company law doctrines, and thus from the perspective of principle and policy, there is no need for special principles to limit the tortious liability of directors. One of the basic objectives of tort law is to force the wrongdoer to compensate the innocent party who suffered damages from the wrongdoer’s acts. In its essence, the liability to make compensation in tort is found on fault, whether or not involving intention to commit the tortious act or some negligent act or mission. The “corrective justice” which “require[s] those who without justification harmed others by their conduct to put the matter right” was seen as the foundation of tort law which justified the compensation on the ground that it is right to impose liability on the person who has caused or was responsible for the wrong. Besides, the tort law also contains an element of prevention in fault-based liability by imposing liability on fraud conducts, with the goal of eliminating or reducing the undesirable behaviour.

On the other hand, the policy objective of company law, however, is to promote the investments in business and to encourage the entrepreneurship. The company law principles, such as limited liability and separate legal entity, are justified from the economic perspective on the basis of promoting business efficiency. The doctrine of limited liability, for Easterbrook and Fischel, can significantly reduce the agency costs of separation between investment and management in public companies and therefore promote the business efficiency. In addition, it is also stated that limited liability can promote the securities markets by making it more efficient and organised, and it can also lower the transactional cost overall. Similarly, the concept of separate legal entity is the base for the operation of the limited liability doctrine which separate the company’s liability and the shareholders as well as the director’s liability.

As aforesaid, the imposition of personal liability to the directors, although does not directly affect the limited liability doctrine, may still in substance detract from the policy goals of limited liability, because in many situations, especially in one man company, the director is also the major or only shareholder of the said company. They argued that the limited liability can be justified on the ground of voluntariness from the contract made between the company and the innocent party. However, it is also submitted that, in relation to the director’s personal tortious liability, different considerations should be given from the contractual voluntary creditors. The scholars argued, unlike contractual creditors whom are voluntary to make their investment to the company hence voluntary to bear the risk of their investment, the tortious creditors are involuntarily involved in the wrongful act committed by the company as well as the director. Therefore, although the company can be liable for the loss caused and to pay the damages, the doctrine of limited liability of shareholders means that the tort victims are in fact not compensated if the company does not have
sufficient assets to satisfy the victims’ claims. As aforementioned, these involuntary tortious creditors are victims of the tortious acts of the company and its directors, to let the directors escape from their personal liability will in essence defeat the principles of corrective justice because “the directors had made a profit from or cause the harmful activities while need not to bear the cost of the said activities, with the victims left to bear the consequence themselves.” Undoubtedly, the injustice caused by refusing to impose personal liability to directors is so overwhelming that cannot be justified by promoting business efficiency. Thus, it has been suggested by various scholars that there should be some scheme of unlimited liability for shareholders in relation to tort liabilities. In this context, even if the directors, who are also the major shareholders of the company, are treated as the agent of the company and imposed personal liabilities under the general principle of agency law and tort law, it does not contrast with the company doctrine of limited liability and separate legal entities because the company law doctrines also permit the shareholders to be liable for some tortious conducts of the company in order to promote justice, which is the ultimate goal of all laws. Hence, the arguments that imposing personal liabilities to the directors will deny the company any meaningful existence cannot be stand. From the previous discussion it can be concluded that, the company law doctrines are only applicable to the contractual creditors but not to involuntary tortious creditors. Stefan Lo has once pointed out in Liability of Directors as Joint Tortfeasors that “the company’s existence is not denied as the company can still be liable in the circumstances, and the company’s other functions and capacities as a separate entity are maintained.” Also, the argument that the policy base for company law is overwhelming than any other laws are obvious wrong because none of these policy considerations should defeat the most basis of law that justice must be promoted. Even Grantham agrees that “in time”, acceptance of the use of the corporate form to carve out exceptions from tortious liability of those acting for the company may “be rejected as a false step”. It is generally agreed that, even if he is right in all the points raised in the previous part, this is “the time” he mentioned to impose personal liability to the directors.

Directors’ Personal Liability in Fraud

1. Standard Chartered Bank – The Leading Authority in Director’s Liability in Fraud

Standard Chartered Bank v. Pakistan National Shipping Corp (No. 2) is the present authority in this area of law. The facts are straightforward. Mr. Mehra, the managing director of Oakprime Ltd which is the seller, contract to ship a cargo to a buyer in Vietnam. Payment for the cargo was to be made by a letter of credit issued by a Vietnamese bank in favour of the seller but subject to a condition. However, the seller failed to fulfil the said condition on time. The ship owner and the seller’s agent agreed with Mr. Mehra to issue a false document proving that the seller has fulfilled the condition. The said document and some other documents were present to the plaintiff bank with a covering letter signed by Mr. Mehra confirming the truth of these documents. Based on these documents, the plaintiff authorised payment to the seller. However, the plaintiff later discovered that the document has been falsely made and therefore the Vietnamese bank refused to pay for it. The plaintiff sued Mr. Mehra and two other defendants for tort of deceit and conspiracy, claiming for the loss occurred from the false document.

In the Court of Appeal of England, the Court held that they were bound to follow the House of Lords’ decision in Williams. By applying the “assumption of personal liability” test in Williams, the Court refused to impose personal liability to Mr. Mehra because the Court concluded that, based on the facts they found, Mr. Mehra had not assumed personal liability in his fraudulent representations and those representations are made on behalf of Oakprime Ltd. The plaintiff appealed against this decision. The House of Lords allowed the appeal and it was held that in intentional tort cases a director is treated as an agent of the company as well as in negligence, but the principles set out in Williams are only applicable in negligence. This case is decided merely on the ground of agency and tort law, whether the principal is a human being or a company will not affect the court’s decision. A director will be held personally liable whenever all the elements in tort can be proved, a person cannot escape his liability in intentional torts by relying on he is acting for the company. Therefore, Mr. Mehra was held personally liable since all the elements of the tort of deceit were proven against him. This case was approved by the Hong Kong District Court in Chopard Hong Kong Ltd. v. Denis Armand Muller. Similarly, when fraudulent acts are involved, a company director can also be personally liable as joint tortfeasor once it has been proved that he had procured or induced the tortious acts to be done by the company or he and the company had joined together in concerted action to secure that those acts were done.

2. Justifications for Imposing Liability on Directors in Fraud

Some jurists argue that exposing directors to personal liability for all torts will heavily harm the doctrine of limited liability in company law. In their opinion, as
aforementioned, company law should prevail. The correct approach should be Court of Appeal of New Zealand in Trevor Ivory that “something special” is required to bring the actions of director’s personal tortious liability, the fact that the director has made some fraudulent activities are irrelevant in deciding the director’s personal liability. In the other words, these jurists argues that the courts should adopt the same principles in relation to directors personal tortious liability despite the fact that in some cases deceitful conduct made by the defendant are involved. It is much easier to justify the courts’ decision in intentional torts and joint tortfeasor than negligence. First and the most important reason is that neither tort law nor company law will never permit a company be used as a device for people to escape personal liability. The purpose of company law is to promote socially beneficial entrepreneurial activities, rather than to excuse the company directors from liability for the deliberately harmful acts. In fact, these decisions have never affected the doctrine of limited liability as well as the doctrine of separate legal entity. Although the director may also be a shareholder whose liability should be limited based on the principle of limited liability, however, as Lord Hoffmann stated in Standard Chartered Bank, the director is liable “not because he was a director but because he committed a fraud.” As a shareholder, the director’s liability is limited; what he really is personally liable for is the fraud he committed personally. Therefore, based on the separate legal entity doctrine, it is right to hold the director personally liable for his or her fraudulent conduct rather than making the company liable, because these conducts were all done by the director personally, rather than done by the company.

Besides, it is unconscionable and unjust to treat the director and employee different in personal liability in tort. For the employees, they will be certainly held personally liable for their intentional tortious act and there is no justification to place the directors in a different position. Otherwise richer people will have a better position in law than the poor ones; the foundation of our legal system that everyone is equal before law will no longer exist. Therefore, for both reasons discussed above, the courts’ decision in deliberate tort and joint tortfeasor can be well justified; in my opinion, the directors’ personal liability should be determined in accordance with the tort law principle both in fraud and joint tortfeasor.

Conclusion

After the above discussion, it seems that neither in the tort of negligent nor in fraud that the arguments of Identification Approach can be stand. The Identification Approach has only considered the issue of director's tortious liability in the context of company law. Its argument that imposing liability will damage or even frustrate company law is based on the presumption that company law should prevail in any conflicts of laws. However, in the previous discussion it has been showed that the issue is very complicated and many considerations, such as the purpose of tort law, policies and justice are involved. The basic presumption of the Identification Approach, in my opinion, is plainly wrong because there is no persuasive reasons have ever been pointed out by those scholars who in favour of Identification Approach while there are lots of reasons against this idea. The Identification Approach is wrong by trying to simplify the issue to only company law related. Therefore, even if, but we do not agree, imposing personal liability on directors may somehow damage the company law principles, it is still the more appropriate approach in the modern legal system comparing to the other one because the law has to balance interests of different groups of the society in order to achieve justice for the whole society. On the other hand, the Agency Approach has rightly considered many relevant factors which Identification Approach fails to consider. It is based on the general goal of all laws that justice must be done which is a also a more stable one compared to the Identification Approach.

Besides, we also agree the idea that the doctrine of limited liability should not be extended to directors. The arguments that extending this doctrine to the directors are against the social policies are very persuasive to me. In fact, the rich people have already had a better position in litigation because they can afford the expense for hiring experienced counsels and the costs for appeals. Thus, extend the principle to those directors’ will only place the riches in an even safer position which is against the basic policy that everyone should be equal before law. Additionally, extending the doctrine of limited liability involves a lot of other matters except the current issue. It is very possible that many unexpected issues will be raised if the courts agree to extend it. Obviously it will lead to a significant change of the company law and may bring in some unpredictable results. The potential risk for extending this doctrine is very high that it is not worth to make such adventure. Hence, I would suggest that, since the Agency Approach is a more preferable approach to achieve justice for the reasons we gave, and the judgment in Williams and MCA Records that directors are the agents of the company and their personal liability should be decided within the general tort law principles are correct on in relation to the director’s personal tortious liability.

The last but not least, we have to confess that there are some limitations of the study. One of the great
limitations of the research is to find a new angle in an intense and sophisticated debate between these academic giants. It is challenging to find originality out of these extensively developed arguments within very limited time. Another limitation for this research is that the paper focuses so much on director’s tortious liability in negligence so that director’s tortious liability in fraudulent act cannot be fully discussed. Besides, the courts of the United Kingdom, Canada and Australia choose very different approaches in relation to director’s tortious liability, however, due to time limitation, this paper have to confine its research mainly to the England which has been followed by the courts of Hong Kong.

Based the abovementioned, it has been suggested that the director’s personal liability in tort should be determined in accordance with the general principles of tort law based on the agency approach rather than any special principles shaped by company law doctrines based on the identification approach which will limited the director’s liability. Arguably, this suggestion is right as a matter of both principle and policy considerations. The discussion above has showed a strong reason that the basic principles of tort law should not be defeated by the application of company law doctrines. Besides, it has also been pointed out imposing personal liability on directors will never damage the basis of company law and the existence of company. Therefore, the conclusion of this independent research is that the personal tortious liabilities of directors should entirely governed by tort law that the director will be personally liable whenever the requirements in these tests are fulfilled, and the House of Lords has properly laid down the tests in this area in both cases of Williams and Standard Chartered Bank despite some minor inconsistencies.

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