



FRAUDULENT TRADING

Accessory liability of professionals?

Stephen Davies QC, Guildhall Chambers

Introduction

1. At common law, equity intervenes against C where there has been wrongful conduct by A against B in which C has knowingly assisted A. This provides B and others prejudicially affected by the conduct an alternative means of recourse against C in circumstances where A might be insolvent or missing. Imposing liability on C also acts as a deterrent against the participation by third parties such as C in wrongful conduct, thereby restricting the opportunity for wrongdoing by the likes of A.
2. The nature and extent of civil secondary liability for a wrongdoing are vexed questions which can arise in diverse circumstances¹. Section 213 of the Insolvency Act 1986 creates the statutory cause of action known as fraudulent trading which can impose civil secondary liability for a wrongdoing in the following terms:

“(1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.

(2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company’s assets as the court thinks proper.”
3. The phrase: “or creditors of any other person” should be noted. Thus, it is legitimate for a liquidator to allege that, for instance, a particular scheme was created and operated by a company in order to defraud HMRC, regardless of whether HMRC ended up as creditors in the liquidation. This demonstrates the scope of the section once the other ingredients of the statutory cause of action are present.
4. In broad terms, the following 3 elements need to be established:
 - a. That the business of the company has been carried out with intent to defraud creditors (whether of the company in question or of a third party), or some other fraudulent purpose;
 - b. That the defendant sought to be made liable participated in the carrying on of the business in that manner; and
 - c. That the defendant did so with knowledge that the transaction in which it was participating was intended to defraud creditors or was in some other way fraudulent.
5. Nevertheless, it is appropriate to commence any explanation of the fraudulent trading provisions by stating that, traditionally, their scope has been the subject of controversy. This controversy was reviewed in and exemplified by the judgment of the Court of Appeal in *Morphites v Bernasconi* [2003] 2 BCLC 53.
6. In that case, the company in question ran a haulage business and was the tenant of warehouse and depot premises under four leases. The business was unprofitable in 1991 and 1992 and the directors identified the principal problem as the onerous rental obligations under the leases. They took advice as to whether and how they could free the company from

¹ See e.g. Sales : The Tort of Conspiracy and Civil Secondary Liability” (1990) C.L.J 491; Elliott and Mitchell : Remedies for Dishonest Assistance (2004) 67 MLR 16.



the liabilities under the leases. On advice they implemented a scheme under which the company ceased trading at the end of 1992 and the business was thereafter carried on by a newco from new premises using a similar name to that of the first company. In 1994 the landlord served a statutory demand for rent and presented a winding-up petition and the company was compulsorily wound up. The liquidator took proceedings against the directors under s.213 alleging that they and the company's solicitors had been knowingly party to the carrying on of the business with intent to defraud creditors, namely the landlord. The case was that the defendants deliberately and deceptively forestalled presentation of a winding-up petition during 1993 to prevent the transactions involved in the scheme being vulnerable to challenge under the Act. The solicitors made a payment into court and the s.213 claim proceeded to trial against the directors only. The deputy judge held that there had been fraudulent trading by the directors but that their liability to make contribution to the company's assets, including a punitive element, had been satisfied by the solicitors' payment into court. The liquidator appealed and the directors cross-appealed.

7. The Court of Appeal held that a business could have been carried on with intent to defraud creditors notwithstanding that only one creditor had been defrauded and by a single transaction but s.213 was not engaged in every case where an individual creditor had been defrauded. It was only where the business of the company had been carried on with intent to defraud that s.213 was engaged. The court found that it was impossible to reach the conclusion, on the facts found by the judge, that the business of the company had been carried on with intent to defraud creditors or in particular the landlord. It had been carried on throughout 1993 with the intent to protect the directors from the penalties to which they would otherwise be exposed under s.216 of the Act as directors of newco for re-using the company's name. The court also decided that the amount of contribution ordered under s.213 should reflect the loss that had been caused to a company's creditors by the carrying on of the business in the manner that gave rise to the exercise of the power to order the contribution. Ultimately, the court held that the judge had been correct to treat the directors' liability as satisfied by the solicitors' payment into court and to make no order against them for costs after the date on which the liquidator accepted that payment.
8. It is essential to appreciate that the decision itself turned on the specific and narrow terms in which the liquidator alleged fraudulent trading (see paras. (27) and (28) of the judgment of Chadwick LJ). The only conduct upon which the liquidator relied at trial in support of his case that the former directors were parties to fraudulent trading was the deception of the landlord: "into believing that it would be paid the sums due under the leases in due time or within an agreed rescheduling time when at all times the [directors] knew and intended that no monies would be paid after [a certain date]." This was indeed a very narrow claim and not one which obviously fell within section 213. However, for present purposes, the importance of this case lies in the review by Chadwick LJ of authorities concerning the nature and extent of the fraudulent trading jurisdiction. In paragraph 46 of the judgment of Chadwick LJ concluded:

"For my part, I would accept that a business may be found to have been carried on with intent to defraud creditors notwithstanding that only one creditor is shown to have been defrauded, and by a single transaction. The Cooper Chemicals case is an example of such a case. But, if (which I doubt) Mr Justice Templeman intended to suggest that, whenever a fraud on a creditor is perpetrated in the course of carrying on business, it must necessarily follow that the business is being carried on with intent to defraud creditors, I think he went too far. It is important to keep in mind that the pre-condition for the exercise of the court's powers under section 332(1) of the 1948 Act - as under section 213 of the 1986 Act - is that it should appear to the court "that any business of the company has been carried on with intent to defraud creditors of the company". Parliament did not provide that the powers under those sections might be exercisable whenever it appeared to the court "that any creditor of the company has been defrauded in the course of carrying on the business of the company." And, to my mind, there are good reasons why it did not enact the sections in those terms."
9. On the other hand, "conventional" fraudulent trading was described in *Carmen v The Cronos Group SA* [2005] EWHC 2403 (Ch); [2006] BCC 451 as follows:



“23....The pleading at part III.E raises what I would describe as a "conventional" case of fraudulent trading, namely, that those in control of T1, Dr Palatin and his associates, fraudulently prolonged the life of T1, with the result that its overall deficiency of assets increased, at a time when they well knew that there was no prospect, indeed in this case no intention, that T1 would ever be in a position or be placed in a position to pay its creditors in full, and that the Cronos companies had assisted those in control of T1 to achieve that result.

24...2)... During the period of Dr Palatin's control until it was placed in liquidation, the business of T1 was carried on with intent to defraud its creditors within the meaning of section 213(1) of the Insolvency Act 1986 in that over that period Dr Palatin put into operation a plan for the removal from it of the assets of T1 and their application other than for the purposes and benefit of T1 by transferring them to individuals and companies in which Dr Palatin had an interest alternatively applying their proceeds for his own or his family's use.”

10. Suppose such trading was present, in what circumstances would (say) the company's accountants be held liable to contribute as a result?

Liability of advising accountants for fraudulent trading ?

11. To break down the section appropriately, can it be said that the accountants (probably as a firm/LLP as a whole - having its partners' knowledge attributed to it):
- a. were party to the carrying on of the company's business; and
 - b. knew that they were being carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose?

(a) when will accountants be "parties to the carrying on" of a business?

12. The meaning and application of this phrase as it appears in s.213 was considered in *Morris v Bank of India* [2004] EWHC 528 (Ch); [2004] BCC 404; [2004] 2 BCLC 279. The liquidators of BCCI succeeded in showing that a series of transactions between itself and the defendant bank were fraudulent and that those individuals at the defendant bank responsible for entering into the transactions knew that they were thereby assisting the former to perpetrate a fraud on its creditors so that the latter was liable to pay compensation under s.213. At an earlier stage of the proceedings, Neuberger J tried the following preliminary issue: "Is a person within the ambit of section 213(2) of the Insolvency Act 1986 if he has participated in the fraudulent acts of the company in liquidation, or is it necessary that such a person carried on or assisted in the carrying on of the company's business?" The Judge's conclusions can be summarised as follows :

- a. as a matter of ordinary language, the ambit of section 213(2) is not limited to those who perform a managerial or controlling role within the company concerned. The concept of being "parties to the carrying on" by a company of a type of business, or of a business in a certain way, is not limited to the person who actually directs or manages the business concerned. If anything it is a more natural reference to people who are not employed by the company at all, but who are third parties to the company.
- b. as a matter of policy, whilst it would be wrong to construe section 213(2) so as to cast its net so wide as to risk stultifying normal business transactions, that is not a good reason for preventing a liquidator from pursuing a person who actively and dishonestly assisted, and/or benefited from, the company in adopting a dishonest course of conduct, which predictably led to lenders to, or shareholders of the company being defrauded.
- c. the wording of section 213(2) can be contrasted with the immediately preceding section 212 and immediately succeeding section 214. Section 212 is concerned with



remedies against people who have misapplied or retained money of a company in liquidation, or who have been guilty of any misfeasance or breach of duty to the company. It extends not only to an officer, a liquidator, an administrator or a receiver, but to "a person who has been concerned or has taken part in the promotion, formation or management of the company".

- d. the legislative history of section 213 reveals that "directors" in previous legislation was replaced by "persons" in 1947 pursuant to the express recommendations of the Cohen Committee.

13. In *Re Gerald Cooper Chemicals Limited (in Liquidation)* [1978] 1Ch 262 it was a creditor who was found liable. The respondent creditor allegedly had accepted as part repayment of a debt owing by the insolvent companies money which he knew had been obtained by fraud on another creditor. Templeman J said :

"In my judgment, a creditor is party to the carrying on of a business with intent to defraud creditors if he accepts money which he knows full well has in fact been procured by carrying on the business with intent to defraud creditors for the very purpose of making the payment. Mr. Evans-Loam(?) said truly that section 332 creates a criminal offence and should be strictly construed, but a man who warms himself with the fire of fraud cannot complain if he is singed."

14. In *Re Augustus Barnett & Son Limited* [1986] BCLC 170, Hoffmann J said :

"The words 'persons ... parties to' may be wide enough to cover outsiders who could not be said to have carried on or even assisted the carrying on of the company's business, but who nevertheless in some way participated in the fraudulent acts. For an example see *Re Gerald Cooper Chemicals Limited*..."

15. On the other hand, in *Maidstone Buildings Limited* [1971] Ch 1085, Sir John Pennycuik V-C dismissed a claim under section 332 of the Companies Act 1948 (the predecessor to section 213) against an employee of the company in question (the company secretary) in circumstances where the company's business had allegedly been carried on in a way which fell within section 213(1). He said (at 1092F to H) :

"The expression 'parties to the carrying on of the business' is not I think a very familiar one, but so far as I can see the expression 'party to' must on its natural meaning indicate no more than participates in, takes part in, or concurs in and that, it seems to me, involves some positive steps of some nature. I do not think it can be said that someone is party to carrying on a business if he takes no positive steps at all, so in order to bring a person within the section you must show that he has taken some positive steps in the carrying on of the company's business in a fraudulent manner. So far as the position of a secretary as such is concerned, it is established beyond all question that a secretary while merely performing the duties appropriate to the company secretary is not concerned with the management of the company. Equally I think he is not concerned in carrying on the business of the company. On the other hand, it is equally well established, indeed it is obvious, that a person who holds the office of secretary may in some other capacity be concerned in the management of the company's business."

16. Referring to this passage, Neuberger J commented :

"In so far as those observations could be said to assist Mr. Adkins' argument, it seems to me that once again one has to remind oneself that they were made in the context of someone who was undoubtedly an employee or agent of the company in circumstances where the company was allegedly carrying on a business falling within section 213. The court was not there concerned with a person who was not employed or agent for the company.

In my Judgment, just as an employee of the company who was merely carrying out orders does not fall within section 213(2) whereas somebody who orchestrates,



organises or can seize of the business concerned does fall within the section, so a company or other entity which carries on (so far as it is concerned) a bona fide business with the company, does not fall within section 213(2), but a company which is involved in, and assists and benefits from, the offending business, or the business carried on in an offending way, and does so knowingly and, therefore, dishonestly does fall or at least can fall within section 213(2).”

17. To take a simple case. Suppose accountants themselves advised on the implementation of a scheme to minimise tax which, on analysis, constituted a fraud on HMRC. This would place them in a very different position from the defendant bank in *Morris v Bank of India* (above). They would not be a counter-party to the fraudulent trading with the company but accountants consulted and instructed by the directors on behalf of the company. In that sense, they would be agents of the company such that the comments and approach of Sir John Pennycuik V-C in *Maidstone Buildings Limited* [1971] Ch 1085 (above) might be of relevance. However, there would be no difficulty finding “positive acts” of the nature described by the judge. Indeed, if they masterminded and promoted the relevant scheme, they would be in the zone of liability.
18. Suppose the company’s in-house accountants knew that the directors were resisting professional insolvency advice to effect a sale of the business within the protection of appropriate formal insolvency procedures. Instead, they cynically promoted the personal interests of the insiders ahead, and at the expense of, the company’s creditors by conniving in a sale to a connected party at undervalue. In doing so, it might well be arguable that they participated in, took part in, and concurred in the trading with a view to achieving that purpose.

(b) knowledge

19. In each case, it is necessary to demonstrate that each of the individual respondents had the requisite knowledge (“knew that it was being carried on with intent”.. etc). This involves actual dishonesty, not merely blameworthiness. Thus, the director whom genuinely believes that right-minded members of the community would see nothing wrong in trading in the manner alleged to be offensive will escape liability. This is the effect of the decision of the House of Lords in *Twinsectra*.²
20. Of course, the court will not lightly make findings of dishonesty against such professionals (for whom such finding would be likely to result in an end to their professional careers). As such, it is appropriate to set out below the legal evidential standards which a liquidator must meet in order to fix proposed respondents with the requisite knowledge of fraudulent trading.
21. The court in *Morris v Bank of India* (above) was principally concerned with the question whether the defendant bank, as the counter-party to the fraudulent transactions, had the requisite knowledge for the purposes of fixing the bank with liability under section 213. It is therefore necessary to mention the material facts of that case in a little more detail. The liquidators of BCCI sought compensation from the defendant bank (BOI), alleging that BOI had knowingly participated in the carrying on of BCCI’s business for a fraudulent purpose or with the intent to defraud BCCI’s creditors, thereby rendering BOI liable under section 213 to pay compensation for the losses sustained to creditors. BCCI entered into a series of six transactions with BOI between 1981 and 1986 which enabled BCCI to conceal bad debts from its auditors and to conceal the fact that, by 1983, it was insolvent. The transactions took the form of loan facilities provided by BOI for a number of companies at BCCI’s request. BCCI

² [2002] 2 A.C. 164 – involving a claim against a person as accessory for breach of trust in which the House of Lords held (Lord Millett dissenting) that it was not sufficient for the defendant’s conduct to be dishonest by the ordinary standards of reasonable and honest people, it was also necessary that he should himself be aware that by those standards he was acting dishonestly. This is not always an easy test to apply and it was clarified by the Privy council in *Barlow Clowes International Ltd v Eurotrust International Ltd* [2005] UKPC 37; [2006] 1 WLR 1476, as requiring only that the claimant establish that the defendant’s knowledge of the transaction was such as to render his participation contrary to normally acceptable standards of honest conduct (and not that he had to have reflected on what those standards were).



made equivalent deposits with BOI and guaranteed the loans. The companies receiving the loans were effectively controlled by BCCI and the loan moneys were applied to servicing other heavily indebted accounts. The loan moneys were repaid after the relevant year end. By concealing its liabilities to BOI, BCCI apparently reduced its outstanding liabilities over the period of time when accounts were prepared. BOI accepted that BCCI had acted fraudulently but denied having any knowledge that it had participated in a fraud.

22. Importantly, BOI's defence was that those individuals who dealt with these matters at the time believed that they were assisting BCCI in a legitimate way and had no reason to think or suspect that the liabilities of the nominated borrower they were taking on for year end purposes were non-performing or, more fundamentally, that BCCI was intent on deceiving its auditors in order to produce a positive balance sheet and accounts. They denied any knowledge of BCCI's deteriorating financial position and accepted BCCI's explanation for the transactions at face value. They therefore also denied the alternative allegation that, even if the purpose of what has been referred to as these "back-to-back arrangements" had been that allegedly stated by BCCI (i.e. the improvement of the apparent ratio of BCCI's earnings to advances), this was known to them in the circumstances to be an essentially dishonest practice, because it could only have been achieved by the removal of bad debts and the transfer of corresponding liabilities to BOI. At trial, the liquidators had to prove that BOI, through its relevant officers and employees, had knowledge that the transactions were for a fraudulent purpose. Such knowledge included BOI deliberately closing its eyes to the obvious fraudulent nature of the transactions, if it was so.
23. The Judge found that a bank employee, S, had been aware of the circular nature of the transactions and that the fact that the transactions were documented and involved lawyers was not conclusive as to their appearance of propriety. Because it was obvious that the transactions were not ordinary loans, S must have known from the second transaction that an improvement in the earnings to advances ratio could not be achieved by the removal of loans over the year end and that only a transfer of non-performing loans would have any significant effect. He must by then have known, since the transactions were circular and the only suggested justification had been removed, that the transactions involved a fraud of some kind. In this way, the judge was able to conclude that S did have knowledge of the relevant kind. The transactions were of such a size that they had to be referred to the board. The board approved the transactions in the sense that they were content to take S's assurances at face value and leave it to him to satisfy himself that it was proper for BOI to go ahead. It was further held that section 213 was capable of applying to a company in the position of BOI and that S's knowledge was to be attributed to BOI, otherwise the policy of the Act would be frustrated. The board had a real concern about the purpose of the transactions but were content to delegate supervision of the transactions and the decision whether to proceed to S.
24. In paragraphs 13-15 of his judgment, Patten J made some important observations concerning the degree of knowledge which the liquidators must establish against persons alleged to have been knowing parties to the alleged fraudulent trading. In particular, he made it clear that it was not necessary that such persons knew the details of the fraud, but rather that they knew that a fraudulent activity was taking place with a view to defrauding someone or for a fraudulent purpose (this is a long passage but it is necessary to set it out in full):

"The liquidators have to show that BOI (through its relevant officers and employees) knew that the six transactions (or one or more of them) were being entered into either to defraud the creditors of BCCI or for a fraudulent purpose. They did not have to know every detail of the fraud or the precise mechanics of how it would be carried out, but clearly they did have to know, either from their own observation of what was being done or from what they were told, that BCCI was intent on a fraud. Knowledge, for this purpose, means what it says. There must have been an actual realisation on the part of BOI that BCCI would, or was likely to, engage in false accounting. A failure to recognise the truth of what was going on is not enough, however obvious that may now seem to have been. The relevant knowledge also has to be contemporaneous with the assistance that was given at the time by entering into the various transactions. Subsequent knowledge based on hindsight is not enough, nor is negligence the test of liability. Mr Hirst QC emphasised in his closing submissions



that it is irrelevant whether BOI is open to criticism for slackness or negligence, however gross. The only issue is whether it knew at the time that it was participating in a fraud. I agree with that. But both sides accept that knowledge, for these purposes, includes so-called blind-eye knowledge, which exists when the party in question shuts its eyes to the obvious because of a conscious fear that to enquire further will confirm a suspicion of wrongdoing which already exists. Knowledge of this kind is part of the Claimants' case, and I dealt with the same point in paragraph 11 of my judgment in *Morris & ors v. State Bank of India*, where I said this:

“Knowledge includes deliberately shutting ones eyes to the obvious, provided that the fraudulent nature of the transactions did in fact appear obvious to those who dealt with these matters at SBI at the relevant time. It is well established that it is no defence to say that one declined to ask questions, when the only reason for not doing so was an actual appreciation that the answers to those questions would be likely to disclose the existence of a fraud. But liability in such cases depends upon that stage of consciousness having been reached. His submission, which I accept, is that one needs to be careful to draw a distinction between a conscious appreciation of the true nature of the business being carried on and a failure, however negligent, to appreciate that fraud was being perpetrated. The case for SBI is that at no time during the course of these transactions did it in fact suspect that anything untoward was going on. The essentials of what is required in order to establish so-called blind-eye knowledge are set out in the speech of Lord Scott of Foscote in the recent decision of the House of Lords in *Manifest Shipping Company Limited v. Uni-Polaris Company Limited* [2003] 1 AC 469, where Lord Scott at paragraph 116 says this:

‘In summary, blind-eye knowledge requires, in my opinion, a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist. But a warning should be sounded. Suspicion is a word that can be used to describe a state-of-mind that may, at one extreme, be no more than a vague feeling of unease and, at the other extreme, reflect a firm belief in the existence of the relevant facts. In my opinion, in order for there to be blind-eye knowledge, the suspicion must be firmly grounded and targeted on specific facts. The deliberate decision must be a decision to avoid obtaining confirmation of facts in whose existence the individual has good reason to believe. To allow blind-eye knowledge to be constituted by a decision not to enquire into an untargeted or speculative suspicion would be to allow negligence, albeit gross, to be the basis of a finding of privity.’ ”

...Dishonesty as such is not in terms a condition of liability under s.213. But if knowledge of the fraud in either of the senses indicated above is established, Mr Hirst



accepts that it must follow that BOI was dishonest. No evidence has been led to exculpate BOI on the basis that, although the bank through its officers realised what BCCI was doing, they saw nothing wrong in it, and it is not, therefore, necessary for me to consider whether that position, if established, would constitute a defence to the claim. The only defence relied on is simply a denial of knowledge. In relation, therefore, to the liquidators' primary and original claim that BOI knew that BCCI was falsely misrepresenting the six transactions to its auditors by concealing its own use of the loans made to Maram, by representing the matching deposits with BOI as unencumbered, and by concealing the existence of the guarantees, no problems of defining the test of liability exist. An awareness of the purpose to which the transactions were being put was inescapably dishonest. The same, I think, goes for the alternative plea that BOI must have realised that the improvement of its earnings to advances ratio could only be effected by the transfer of non-performing debt and the consequent improvement in BCCI's profit before tax in each year. It is common ground between all the expert witnesses who gave evidence (both bankers and accountants) that the removal of bad debts would have been impermissible even by the standards of the time, and that the auditors, if notified, would have insisted on the reversal of the transaction in the accounts or the making of suitable provision. The improvement in the ratio could only therefore have been successful if the removal of the bad debts was effectively concealed from the auditors. None of the factual witnesses suggested that they would have regarded this as an honest practice. But in relation to the new plea about window-dressing, different considerations may apply. Paragraphs 93.2 and 96F (i) and (ii) of the Re-Re-Amended Particulars of Claim ("RRAPOC") allege that even the more limited possibility of switching assets in the balance sheet by converting loans and advances into deposits due from banks would have indicated greater liquidity than was the case and was itself a fraudulent practice. The liquidators' additional case is that, even if BOI was told and believed that the only purpose of the six transactions was to window-dress the accounts in this way, this would still amount to knowing participation in a fraud, because what was contemplated was likely to mislead anyone reading BCCI's accounts and was not a practice which, judged by the standards of honest bankers at the time, operating in the City of London, could have been recognised by BOI as either honest or legitimate.

Mr Hirst submits that the liquidators must prove (in relation to this plea) not only that BCCI's explanation of the purpose of the transactions disclosed a scheme which, viewed objectively, was dishonest, but also that this belief was shared by the officers of BOI to whom the explanation was given. It is important to note that this submission is not advanced as part of an argument that s.213 requires proof not only of knowledge, but also of dishonesty. It is based on the terms of the RRAPOC, which at paragraph 96A alleges that BOI knew or believed that the explanation of the improvement in BCCI's earnings to advances ratio (if given and true) disclosed a dishonest scheme on the part of BCCI. This plea therefore depends upon BOI being aware and appreciating at the time that window-dressing of the kind allegedly contemplated by BCCI was dishonest, and therefore requires the Court to focus on BOI's views about the appropriateness of what was being done. Therefore in this limited area what needs to be proved is what Lord Hoffmann in *Twinsectra v. Yardley* [2002] 2 AC 164 at page 170c described as a dishonest state of mind: i.e. a consciousness that one is transgressing ordinary standards of honest behaviour. Clearly that test is inapplicable except by reference to the standards of such behaviour prevailing at the time. I therefore accept Mr Hirst's submission that if liability is to be established on the basis of this new plea, conscious dishonesty in the sense I have described is an issue and must be proved."

25. Each case will depend on its facts but a liquidator will be looking for strong prima facie evidence for establishing (usually by inference and/or after interview) that the individual proposed respondents were conscious that they were transgressing ordinary standards of honest behaviour by reference to the standards of behaviour prevailing at the time. Furthermore, the court's traditional reluctance to make findings of dishonesty against



professionals will be eased by such features as patent artificiality of transactions or surrounding circumstances carrying the badge of fraud.

(c) The contribution - quantum

26. The method of calculating the contribution which a person should be required to make as a result of a finding of fraudulent trading may be different from the method applicable for wrongful trading. A contribution in respect of fraudulent trading is usually calculated by reference to the loss suffered by the creditors of the Company which is attributable to the fraudulent trading to which the judge had held that they were knowingly parties. The method was discussed by Chadwick LJ :

“There must, as it seems to me, be some nexus between (i) the loss which has been caused to the company’s creditors generally by the carrying on of the business in the manner which gives rise to the exercise of the power and (ii) the contribution which those knowingly party to the carrying on of the business in that manner should be ordered to make to the assets in which the company’s creditors will share in the liquidation. An obvious case for contribution would be where the carrying on of the business with fraudulent intent had led to the misapplication, or misappropriation, of the company’s assets. In such a case the appropriate order might be that those knowingly party to such misapplication or misappropriation contribute an amount equal to the value of assets misapplied or misappropriated. Another obvious case would be where the carrying on of the business with fraudulent intent had led to claims against the company by those defrauded. In such a case the appropriate order might be that those knowingly party to the conduct which had given rise to those claims in the liquidation contribute an amount equal to the amount by which the existence of those claims would otherwise diminish the assets available for distribution to creditors generally; that is to say an amount equal to the amount which has to be applied out of the assets available for distribution to satisfy those claims.”

27. In paragraph 122 of his judgment in *BCCI v Bank of India* (above), Patten J commented:

“The power of the Court under s.213(2) to order a contribution to be made is framed in wide terms, but there has on authority to be some nexus between the loss caused to creditors as a result of the fraudulent trading and the contribution which the knowing party is required to make: see *Morphitis v. Bernasconi* [2003] 2 BCLC 53. I am not persuaded that the Court has jurisdiction to, or should, exercise this power so as to make a punitive award unconnected to and disproportionate to the loss which the Respondent can properly be regarded as responsible for. That said, any award, although essentially compensatory in nature, can only be a reasonable approximation to the damage which the Respondent’s conduct has caused or contributed to. This calculation is not and cannot be a matter of exact science and some elements of it will inevitably be broad-brush. Ultimately it is a matter of judgment whether the end figure represents reasonable compensation proportionate to BOI’s role in this matter.”

28. This area of the law remains undeveloped, as indeed it does in the law of accessory or secondary liability generally.³ There are several ways in which the court might calculate the relevant contribution - in respect of which the liquidator might seek a subsequent inquiry (see, *Rubin v Gunner* [2004] 2 BCLC 110). Although essentially compensatory in nature, this is not to say that the compensation is always loss-based and never gains-based. The quantum or extent of the contribution can depend greatly on the precise findings of fact made by the court after trial on liability and even on the evidence of the liquidator’s expert on quantum. The issues here will be explored at the seminar.

Stephen Davies QC
Guildhall Chambers
January 2011

³ See Ridge : Justifying the Remedies for Dishonest Assistance 124 (2008) LQR 445

