House of Lords confirms auditors are not liable for the fraudulent acts of a "one-man" company - Moore Stephens (a firm) v Stone& Rolls Ltd (in liquidation) [30.7.09]

Stone & Rolls Ltd (S&R) had been used as a vehicle for defrauding banks by a Mr Stojevic, who was the “sole directing mind and will and the beneficial owner of S&R”. On discovery of the fraud, its main victim, Komercni Bank SA, successfully sued S&R and Mr Stojevic for deceit in the sum of almost US$100 million. When S&R could not pay, on Komercni’s petition, S&R went into liquidation. The liquidators then turned their attentions to S&R’s auditors, Moore Stephens (MS). They brought a professional negligence claim (in S&R’s name) against them for just under US$174 million – essentially, for negligently failing to detect Mr Stojevic’s dishonest behaviour during the course of various audits, leading to ongoing losses to S&R’s creditors.

MS applied to strike-out the claim on the basis of the public policy doctrine of *ex turpi causa non oritur actio*, i.e. an action may not be founded on illegality. At first instance, the application failed but MS appealed to the Court of Appeal, which reversed the decision. S&R appealed to the House of Lords.

MS accepted, for the purposes of this application, that they had acted in breach of their relevant duty of care, and that such breach had enabled Mr Stojevic to continue with his fraudulent activity. The liquidators of S&R had to accept that Mr Stojevic had perpetrated the frauds. However, they contended S&R was only vicariously, not primarily, liable for that fraudulent conduct; on that basis, and by reference to previous legal authority, S&R
argued that MS could not rely on ex turpi causa to defeat its claim.

**Decision**

In dismissing the appeal, the House of Lords recognised S&R and Mr Stojevic were distinct legal entities but, equally, that in reality, S&R was merely a corporate vehicle used by Mr Stojevic to effect his frauds. There were no other participants in S&R. In these particular circumstances, S&R was primarily, and not just vicariously, responsible for Mr Stojevic’s frauds. Accordingly, MS were entitled to rely on the doctrine of ex turpi causa. To hold them liable to S&R would be to allow S&R to benefit from its own illegal activity.

As Lord Phillips put it, “I have reached the conclusion that all whose interests formed the subject of any duty of care owed by Moore Stephens to S&R, namely the company’s sole will and mind and beneficial owner Mr Stojevic, were party to the illegal conduct that forms the basis of the company’s claim. In these circumstances ... ex turpi causa provides a defence.”

**Comment**

This case, whilst welcomed by auditors and their professional indemnity insurers, should not be considered of universal application in respect of matters involving fraud, as the ex turpi causa defence will not apply to the vast majority of companies (where there is more than one shareholder and control is exercised by more than one person).

In the current economic climate, it is to be expected that liquidators will continue to consider any opportunity they have to pursue claims against the (insured) auditors and other professional advisers of companies in difficulty.

For further information contact Kennedys’ London office: Peter Ellingham or Andrew Mace, 0207 667 9667, Birmingham office: Robert Welfare, 0121 214 8033.