EXTRA DIVISION, INNER HOUSE, COURT OF SESSION

[2014] CSIH 45
CA162/08

OPINION OF THE COURT

delivered by LORD DRUMMOND YOUNG

in the cause

JOHN DRYBURGH

Pursuer and respondent;

against

SCOTTS MEDIA TAX LTD (IN LIQUIDATION) and

TIMOTHY BRAMSTON as liquidator thereof

Defenders and reclaimers:

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Lady Smith

Lord Drummond Young

Lord McGhie

Act: Simpson; Party

Alt: Lake, QC; HBJ Gateley

23 May 2014

[1] The respondent is a chartered accountant who specialized in the field of taxation. The first reclaimer, Scotts Media Tax Ltd (referred to as "SMT"), began to trade in 2000. It was a company set up by the respondent for the purpose of facilitating private film partnerships, which at that time attracted favourable tax treatment under section 48 of the Finance (No 2) Act 1997. From August 2000 onwards 100 shares in SMT had been issued, 70 of which were held by the trustees of the Dryburgh Trust, a trust set up by the respondent for the benefit of himself and members of his family, and the other 30 shares by Alison Young. The respondent and Alison Young were the only directors of the company. Alison Young resigned as a director on 26 June 2002, leaving the first respondent as the only director.

[2] The business of SMT consisted of bringing together private individuals to form private film partnerships under a sale and leaseback initiative then promoted by the government through the favourable tax regime that was available under section 48 of the Finance (No 2) Act 1997, and providing services to such partnerships under agreed letters of engagement. In each case, SMT agreed to provide the partnership with all necessary administrative, accounting, audit and tax compliance services over a period of 15 years, that being the period required by the relevant Inland Revenue Statement of Practice. The respondent emphasized in evidence that the greater part of the work required to be carried out for a partnership during its first year of existence. The business of SMT grew rapidly during 2000 and early 2001.

[3] On 17 September 2001 the directors of SMT, with a view to implementing a share option scheme, resolved to establish a funded unapproved retirement benefit scheme ("FURBS") known as Scotts Media Tax

FURBS No 1, a pension scheme for the benefit of the respondent. On 27 September 2001, pursuant to board resolutions, SMT implemented a scheme which involved the grant of a share option to the trustees of the FURBS and the payment to Alison Young of a bonus. The result of the scheme was that the FURBS received a benefit amounting to £654,345; and Miss Young received a payment amounting to £102,304. The scheme and bonus payment are referred to as "the September transactions". On 26 November 2001, pursuant to a further board resolution, SMT declared a dividend of £100,000, which resulted in a payment to Miss Young of £30,000; the trustees of the Dryburgh Trust waived their entitlement to their share. The dividend is referred to as "the November dividend". SMT ceased trading towards the end of 2001, and its business was de facto transferred to another company, Scotts Private Client Services Ltd (referred to as "SPCS"). SMT was placed in voluntary liquidation on 22 September 2005.

The liquidation of SMT

[4] When SMT was placed in voluntary liquidation, Mr James Dickson was appointed liquidator. The respondent signed a declaration of solvency. Subsequently an assessment to tax was raised by HMRC. As a result Mr Dickson formed the view that SMT was unable to pay its debts in full, and convened a meeting of creditors, which took place on 2 March 2007. At the meeting, the winding up was converted into a creditors' voluntary winding up, and the second reclaimer was appointed liquidator in place of Mr Dickson. The statement of affairs prepared by the liquidator for the purposes of the meeting disclosed no assets and liabilities of £1,354,582. The liabilities consisted of a claim by HMRC for £304,482, a claim by Indigo Media Partnership for £1,000,000 and a claim from RLH Crawford for £50,000. The latter two claims were provisional claims in respect of alleged losses arising from advice given by SMT in the course of its business. Those claims have not even now been finalised, and therefore have neither been accepted nor rejected by the liquidator. The claim by HMRC related to the accounting period from 1 October 2000 to 30 September 2001. It arose out of the scheme implemented by the directors in September 2001. It is now accepted by the respondent that the claim by HMRC is valid.

The present proceedings

[5] The liquidator, acting through SMT, has made financial claims against the respondent on two grounds. First, it is claimed that the September transactions amounted to a breach of the fiduciary duties that the respondent and Miss Young owed to SMT as directors. Those transactions resulted in SMT's being deprived of a total of £756,649, with no substantial correlative benefit. The result, it is said, is that SMT was left with no material assets and insufficient resources to perform the contractual obligations that it had undertaken to the film partnerships or to satisfy liabilities to its employees, its landlords or its other creditors. Consequently the reclaimers, SMT and the liquidator, now seek payment of the sum of £756,649 from the respondent. They do so on the basis that the respondent and Miss Young were in breach of their fiduciary duties to act in good faith in the interests of the company, to act for a proper purpose, and not to allow their personal interests to conflict with those of SMT. Secondly, the reclaimers aver that, as directors of SMT, the respondent and Miss Young owed the company common law duties to exercise reasonable skill, care and diligence in the conduct of its business, and that in paying the November dividend of £30,000 to Miss Young the respondent acted in breach of those duties, as SMT had insufficient distributable assets to justify payment of any such dividend.

[6] The present proceedings began when the respondent raised an action for declarator that the events narrated above did not confer on SMT or the liquidator any claim against the respondent for damages for breach of fiduciary duty or negligence, for an accounting, or for an indemnity under section 322 of the Companies Act 1985 or any other compensatory award. Separately, the respondent asserted that any such claim had prescribed. The reclaimers counterclaimed for payment of sums that are said to have been received by the respondent through breach of his fiduciary and other duties to the reclaimers, amounting to £756,649 and, separately, £30,000. In doing so they rely on the grounds outlined in paragraph [5] above. They also counterclaimed for payment of the sum of £654,345 that was said to have been received from SMT as the result of a fraudulent transaction, but that claim is no longer insisted in. The action and counterclaim proceeded to proof before the Lord Ordinary, who held that the respondent was in breach of fiduciary duty in

respect of the September transactions and in breach of a duty of care owed to SMT in respect of the November dividend. He nevertheless held that both of those claims had prescribed. On that basis he granted absolvitor in respect of the conclusions of the counterclaim. In view of that finding the Lord Ordinary did not find it necessary to grant declarator as sought in the principal action, or any modification of that declarator, and he accordingly dismissed the principal action.

The September transactions and the November dividend

[7] Extensive evidence was led before the Lord Ordinary, but it is not necessary to rehearse this in detail for the purposes of the reclaiming motion since the critical facts were largely agreed. It should be recorded that, before the September transactions were effected, the respondent had sought advice on the tax implications for SMT of the proposals, from RSM Tenon, accountants, and Mr Andrew Thornhill, QC, an English tax barrister. Nevertheless, the liquidator argued that the respondent was under an obligation to act bona fide in the interests of SMT, and that the September transactions were not in SMT's best interests, as they removed from the company sums totalling £756,649. Even if the company was not rendered insolvent by the payment of those sums, it lost assets, and that loss of assets required to be justified. No benefit accrued to SMT, and consequently there was no justification for the payments. The pursuer and Miss Young were said, in the relevant board minutes, to have received the payments in recognition of their services, but they had both been remunerated for those services; consequently that could not be a justification.

[8] The Lord Ordinary accepted that the liquidator's argument was correct. He stated (at paragraph [95] of his opinion) that it might well be the case that the pursuer had brought success to SMT through his skill and hard work, and he accepted that there were ways in which that might legitimately be rewarded, as through an increased salary, or payment of a dividend to shareholders. What happened, however, did not fall into any of these categories. While payment of a bonus might have been acceptable, even after the services had been rendered, it was necessary in such a case that the bonus scheme should be designed to provide an incentive to directors or employees and thereby to benefit SMT. In the present case, the Lord Ordinary thought that no after the event bonus could possibly be said to be for the benefit of SMT. He was not persuaded that the respondent believed that the September transactions would be in the best interests of SMT, or that he ever gave any consideration to that question. The payments made to Miss Young and the FURBS trustees were for the benefit of Miss Young and the respondent's family, and only for their benefit. They were "simply a means of stripping out... the assets of SMT to pay the directors for nothing in return".

[9] The Lord Ordinary arrived at that view without consideration of the financial position of SMT. When the financial position was considered, however, it could be seen that the effect of the September transactions was to leave SMT without any appreciable assets to carry on its business. The audited accounts for the year ended 30 September 2001 showed net assets of only £1,787. Even that figure was based on the assumption that the loss of £654,345 that resulted from the granting of the share option to FURBS as part of the September transactions could form a deduction from profits for corporation tax purposes. It is now accepted that the sum of £654,345 did not form a proper deduction from profits. Furthermore, SMT ceased to carry on its business in late 2001, shortly after the September transactions had been effected. Consequently the result of the September transactions was to leave SMT with at best minimal assets but an obligation to make future payments of rent and salaries and to provide services to the film partnerships under the 15 year contracts that SMT had entered into. On this basis, the Lord Ordinary concluded, it was difficult to see how on any view payments to directors totalling £756,649 could be thought to be the best interests of SMT (paragraph [96]). The Lord Ordinary indicated that, for the avoidance of doubt, he was satisfied that the respondent did not believe that those payments were in the best interests of SMT.

[10] Furthermore, within a week after the transfer of sums totalling £756,649, SMT's business, in the form of the benefit of existing contracts and all future business, had been transferred to SPCS. That deprived SMT of the income stream that would be required to meet its future obligations. It was contended that SMT's future obligations would be met by SPCS, but the Lord Ordinary considered that irrelevant in assessing whether the payments made in September had been in the best interests of SMT. Unless there were a fixed intention on

the part of the directors that SMT should continue to carry on its business, it could not be said that any such payment was in the best interests of SMT. The Lord Ordinary was not satisfied on the evidence that the directors had any such fixed intention, and on that basis he could see no possible benefit to SMT in making the payments involved in the September transactions.

[11] The Lord Ordinary accordingly held that the respondent was in breach of the fiduciary duties that he owed towards SMT. For reasons that it is not necessary to discuss in the present opinion, he further held that the liquidator had failed to make out any case based on breach of the duty of skill and care owed by the respondent to SMT in respect of the September transactions. Moreover, the September transactions did not amount to a fraud on the creditors at common law, on the basis that the respondent had taken tax advice and was entitled on the basis of that advice to believe that the loss of £654,345 was properly deductible against profits for corporation tax purposes. The liquidator and SMT had a further claim in respect of the November dividend, to the effect that in authorizing payment of such a dividend the directors were in breach of their common law duty of care to the company. The Lord Ordinary held that this claim was established. First, at the time when payment of the dividend was authorized no accounts of any sort were available to the directors, and consequently there was no material on which they could properly assess distributable profits. Secondly, by the time of the dividend SMT had transferred the benefit of its business to SPCS and would therefore be unable to receive and keep the amounts invoiced to its customers. Thirdly, the dividend authorized was not confined to the £30,000 paid to Miss Young, but included the additional £70,000 that was probably distributable among all shareholders. The Lord Ordinary accordingly came to the interim conclusion that the liquidator and SMT were entitled to decree for payment of £756,649 in respect of the respondent's breach of fiduciary duty in authorizing the September transactions and decree for payment of £30,000 in respect of the respondent's breach of his common law duty of care in respect of the November dividend.

Prescription

[12] The Lord Ordinary then considered whether the reclaimers' counterclaim had prescribed. Section 6(1) of the Prescription and Limitation (Scotland) Act 1973 provides that the obligations specified in Schedule 1 to the Act prescribe after five years; those obligations include any obligation to make reparation, any obligation of accounting and any obligation arising from a contract. The counterclaim had been intimated on 23 December 2008 and the interlocutor giving leave to bring the counterclaim in the present proceedings was dated 14 January 2009. On either basis, the claim had been made substantially more than five years after the authorization of the September transactions and November dividend, which occurred in the latter part of 2001. For the reclaimers it was submitted to the Lord Ordinary that prescription had not occurred for two separate reasons. First, it was argued that the right of action in respect of the respondent's breach of fiduciary duty was imprescriptible in terms of Schedule 3 to the 1973 Act. Secondly, it was submitted that, under section 6(4) of the Act, so long as the pursuer was responsible as a director for the conduct of the affairs of SMT (before the liquidator was appointed in September 2005), the running of prescription was suspended on the basis that the reclaimers had been induced to refrain from making a claim through error induced by words or conduct by the respondent, or alternatively by fraud on the part of the respondent. The Lord Ordinary rejected the reclaimers' submissions on both of these heads. He accordingly concluded that the reclaimers' rights of an action against the respondent had prescribed and granted absolvitor in respect of the counterclaim.

[13] It is the Lord Ordinary's decision on the question of prescription that is now challenged. The reclaimers have, however, departed from the submission based on Schedule 3 to the 1973 Act, to the effect that the obligation founded on was imprescriptible. Consequently it is only section 6(4) of the Act that is now relevant. That subsection is in the following terms:

"In the computation of a prescriptive period in relation to any obligation for the purposes of this section-

(a) any period during which by reason of-

(i) fraud on the part of the debtor or any person acting on his behalf, or

(ii) error induced by words or conduct of the debtor or any person acting on his behalf,

the creditor was induced to refrain from making a relevant claim in relation to the obligation,...

shall not be reckoned as, or as part of, the prescriptive period".

[14] In our opinion paragraph (a) of that subsection is applicable to the facts of the present case as found by the Lord Ordinary. We consider that during the period of delay that started in the latter part of 2001 with the September transactions and the November dividend and concluded with the winding up of SMT in September 2005 SMT was induced to refrain from making a claim against the respondent by error induced by his conduct, and also by fraud, in a very specific sense, on the part of the respondent. Leave to bring the counterclaim was granted on 14 January 2009, which is well within five years of SMT's winding up. We should perhaps add that it is possible that the period of delay during which SMT was induced not to make a claim continued until the original members' voluntary winding up was converted into a creditors' voluntary winding up, on 2 March 2007, but for present purposes it is unnecessary to consider events after September 2005.

[15] Before considering the details of the construction of section 6(4)(a), we should make two general observations. First, the exception to the general rule of prescription that is found in that subsection must in our opinion be construed purposively, in such a way as to give effect to the clear objectives of the subsection. Those can be ascertained by reference to the circumstances to which the language of the statute relates and external factors such as the policy that underlies it. Secondly, throughout the period between the September transactions and the winding up of SMT the respondent was a director of the company and consequently stood in a fiduciary position towards it. This is important. A fundamental principle applies to all fiduciary relationships, a fiduciary may not place himself in a position where his interest and his duty may possibly conflict, and if he does so he is obliged to account for any loss to his principal, or to make good any loss suffered by his principal: *Aberdeen Railway Co* v *Blaikie Bros*, 1854, 1 Macq 461, at 471, per Lord Cranworth LC; *Commonwealth Oil and Gas Co Ltd* v *Baxter*, 2010 SC 156, at paragraphs [71]-[74] and [78], per Lord Nimmo Smith. Underlying this principle are notions of trust, confidence and good faith.

[16] In the present case the respondent, through the FURBS trust, took a very substantial benefit from SMT, as did Miss Young. That benefit was arranged by the directors, the respondent and Miss Young. The Lord Ordinary has held that it amounted to a breach of fiduciary duty on the respondent's part, a conclusion which we consider to be plainly correct. Thereafter no action was taken by SMT to challenge the transaction. This occurred during a period when the respondent was one of the two directors who had charge of the day-to-day business of the company (until Miss Young resigned in June 2002) or was the sole director. During all this period the respondent's fiduciary duties continued. The result was that he continued to be under a duty to ensure that no conflict of interest arose between his own interests and those of SMT. In the case of the potential claim that SMT had against him, there was a clear and specific conflict of interest.

[17] In those circumstances we are of opinion that the respondent was under an obligation, as an aspect of his overall fiduciary responsibilities, to inform SMT about the existence of the conflict of interest and the possible claim against him. That appears to us to be clearly implied by the basic duty of a fiduciary to ensure that his personal interest does not conflict with his duty to his principal. On the Lord Ordinary's findings, however, the respondent did not tell SMT about the conflict of interest and the possible claim. This may have occurred either because the respondent was unaware that SMT had any claim against him or because he decided to ignore any such claim or the possibility of such a claim. In either event, we are of opinion that the result was continuing breach of fiduciary duty; the existence of a breach of fiduciary duty must be determined on objective criteria, and ignorance of the legal significance of a fiduciary's acts will not provide a defence to a claim for breach of duty.

The construction of section 6(4)

[18] We have indicated that section 6(4) must be given a purposive construction. The underlying purpose of the subsection is in our opinion to deal with the type of situation considered in *Caledonian Railway Co* v *Chisholm*, 1886, 13 R 773, a case dealing with the old triennial prescription. In that case it was held that as a result of the conduct of the defender it had been impossible for the pursuers to discover that money was due to them until after the period of prescription had expired, but that the Act that created the prescription did not apply in such circumstances. The rationale of the decision is stated as follows by LP Inglis (at 776):

"[The statute] undoubtedly implies that there is negligence upon the part of the creditor, that he ought to have pursued his action sooner, and that he ought not to have allowed the three years to elapse.... It is clear to my mind, therefore, that wherever a case of this kind can be made, that the failure to sue is due to the conduct of the defender (whether it amounted to fraud or not), to concealment on the part of the defender, or to the bringing forth of pretences which are false in fact, whether fraudulent or not, the pursuer cannot be visited by the penalty of the statute, because there is no negligence upon his part, but the sole cause of the delay in bringing forward his claim and raising the action is the conduct of the defender".

Likewise, Lord Shand stated (at 777):

"Now, it appears to me that whether the representation [by the debtor] was made from an improper motive or not, if it was a statement which was false in itself, it deceived the company to whom it was made, and deprived them for the time of the power of making a charge, because they relied on that representation, and that being so, it appears to me that this is not a case of the class [which is] struck at by the statute".

Thus the statute was regarded as intended to prevent undue delay in raising proceedings, but if that delay was caused by the conduct of the debtor, as by concealment or false pretences, whether fraudulent or not, the purpose of the statute did not apply and consequently the prescriptive period should not run.

[19] More recently, section 6(4) was considered in *BP Exploration Operating Co Ltd* v *Chevron Transport (Scotland)*, 2002 SC (HL) 19. In that case, too, a purposive approach was adopted towards the statute. Lord Hope (at paragraphs [27]-[28]) referred with approval to *Caledonian Railway Co* v *Chisholm*, and also to the report of the Scottish Law Commission on Reform of the Law Relating to Prescription and Limitation of Actions (1970, Scot Law Com No 15), which led to the enactment of the 1973 Act. The latter report stated:

"We consider that on equitable grounds a defence against the suggested new short negative prescription should similarly be available to the creditor if he has been deterred from taking action within the prescriptive period by fraud or concealment by the debtor or by error on the part of the creditor, but only where the error has been induced by the words or conduct of the debtor".

That approach was reflected in section 6(4), which is based on the Bill appended to that report. Lord Hope then considered the meaning of the word "refrain" as used in section 6(4), and concluded that the period of time covered by that word "includes time when the creditor does nothing to enforce the obligation, whether or not this is the result of a conscious decision on his part not to press the claim": paragraph [33]. In the same case Lord Clyde discussed the meaning of the word "induced". He thought that it implied "a more vigorous connection than a merely causal one, although that element must be embodied in it". The word "induced" was used in relation to error, which in the context indicated something short of fraud; thus the word did not necessarily carry any sinister overtone. He continued (at paragraph [65]):

"The debtor may have been acting entirely innocently and in good faith, but nevertheless has led the creditor to believe something different from the truth. In my view what is meant is that the debtor has led the creditor into error by his, or his agent's, words or conduct and because of the error the creditor has been brought into the position of refraining from making a claim".

The word "refrain" should not be narrowly construed, and in context merely meant that the creditor did not raise proceedings: paragraph [66]. Lord Clyde also endorsed the approach found in *Caledonian Railway*, *supra*: paragraph [67].

[20] Thus the fundamental policy underlying section 6(4), expressed in *Caledonian Railway*, is that any delay induced by actings of the debtor that misleads the creditor, whether through fraud or otherwise, should not count towards the running of prescription. The basic purpose of prescription is to ensure that claims are brought promptly; in that way claims may be decided before evidence is lost and the parties may be made certain of their legal rights. In a case where delay has been induced by the debtor's actings, the failure to act promptly is not the responsibility of the creditor, and thus it is clearly unfair that his claim should be defeated by the passage of time. LP Inglis in *Caledonian Railway* states that in such a case there is no "negligence" on the part of the creditor, which is no doubt true, but the point is perhaps somewhat wider: as a matter of basic fairness creditor should not be prejudiced by delay induced by the debtor. That is the clear purpose of section 6(4), and in our opinion it follows from that purpose that the subsection should not be construed restrictively. Such a view is supported by views expressed in *BP Exploration*, *supra*, as to the meaning of the word "refrain", which is wide enough to apply to mere inaction, and the word "induce", which covers an error brought about by words or conduct.

States of mind

[21] For section 6(4) to apply to the facts of a case, it is necessary that a specific mental state should exist: either error on the part of the creditor or fraud on the part of the debtor. When companies are involved, this gives rise to a further issue, that of attributing a state of mind to a company. This is of course a problem that arises in many other areas of the law. In the words of Viscount Haldane LC in *Lennard's Carrying Co Ltd* v *Asiatic Petroleum Co Ltd*, [1915] AC 705, at 713, "[A] corporation is an abstraction. It has no mind of its own any more than it has a body of its own". Thus the requisite state of mind must exist in one or more individuals and must be attributed to the company. In the context of relationships that have their origin in contract or in other forms of consensual relationship, such as the existence of a limited company, two general solutions have been used. First, in some cases it may be apparent that a particular individual or group of individuals, such as the board of directors, is the "directing mind and will of the corporation, the very ego and centre of the personality of the corporation": *Lennard's Carrying Co Ltd*, at 713. In such a case, it is the state of mind of the individual or body that forms the directing mind and will which will be the state of mind of the company.

[22] Secondly, in other cases the corporate organization may be more complex, so that responsibility for the particular area of activity in question falls on particular officers or employees of the company. That situation was considered by the Privy Council in *Meridian Global Funds Management Asia Ltd* v *Securities Commission*, [1995] 2 AC 500, where Lord Hoffmann (at 506) referred to the rules of attribution that determine what acts are to count as acts of the company (and, by extension, what states of mind in individuals are to be treated as the mental state of the company). In some cases the rules of attribution are found in the company's constitution, typically the articles of association, but those will normally only cover part of the actings of the company. For that reason the law must use general rules of attribution, available to natural persons as well as companies, which are founded on the law of agency. Thus a particular officer or employee, or a group of such individuals, may be appointed an agent of the company, whether formally or informally, and whether for a general area of the company's activity or for a particular transaction, on an *ad hoc* basis. Within that area of activity, or for the purposes of that particular transaction, it is the state of mind of the relevant agent that is the state of mind of the company. Furthermore, the application of these general principles to any particular case will inevitably be heavily contextual, as Lord Hoffmann points out in *Meridian* at 507.

[23] An example of the application of these principles is found in *El Ajou* v *Dollar Land Holdings PLC*, [1994] BCCI 143, where the defendant company had received funds that represented the proceeds of fraud. The fraud had been carried out by third parties, but the chairman of the defendant company was aware that

the funds that had been received by them were the proceeds of fraud. The chairman's knowledge was attributed to the company; he was regarded as the company's directing mind and will. That was so even though he acted without the authority of a board resolution. The chairman had ceased to be a director of the company at a point some months after arrangements had been made for receipt of the funds, but before the final payment was received. The Court of Appeal nevertheless held that for the purposes of that final payment the defendant company continued to have knowledge that the funds had been dishonestly obtained. Nourse LJ stated (at 152) that, as the defendant company had the requisite knowledge at the time when it became involved in the project, it would be "unrealistic to hold that it ceased to have that knowledge simply because the mind and will that had been the source of that played no part in the receipt of the asset itself".

[24] On the particular facts of the case that result appears to us to accord with common sense, although it apparently means that the company continued to have knowledge of the fraud even though none of the current officers or employees was aware of it. Nevertheless, the critical feature appears to us to be the fact that the final payment was the result of a series of transactions whereby the proceeds of the fraud were passed through another company, which took an interest in a development that was ultimately passed to the defendant company. When that process began, an officer of the defendant company did have the requisite knowledge of fraud. In our opinion that meant that the whole transaction whereby the funds were passed through the other company to, ultimately, the defendant company was affected by the fraud. For this purpose it is not necessary to hold that the knowledge of the former chairman was retained by the defendant company throughout; it is enough that the transaction considered as a totality resulted from a fraud of which he was aware at the outset. For this purpose it is the outset of the transaction, when it was decided upon, that is the critical time.

Application to the facts of the present case

[25] It appears from the Lord Ordinary's findings that the respondent did not stop to consider what was in the best interests of SMT when deciding to enter into the September transactions (paragraph [123]). The failure to take account of SMT's interests must have continued thereafter, because the claim for breach of fiduciary duty existed as soon as the September transactions had been effected but nothing was done to remedy the breach, whether by undoing the transaction on a voluntary basis or by instigating court proceedings. That is not surprising; if the respondent had not considered the conflict of interest between himself and SMT when the transaction was carried out, it is probable that unless something had happened to alert him to the problem he would simply continue to be unaware of the conflict. That was manifestly an error on his part. It was an error that affected him in his personal capacity, but it was also clearly an error that affected him in his capacity as a director of SMT. Until Miss Young resigned in June 2002 he was one of only two directors, and it is clear from the Lord Ordinary's findings in fact that he was the dominant force behind SMT. After Miss Young resigned he was the sole director. In these circumstances we are of opinion that his knowledge, or the lack of it, must be attributed to the company. That attribution must include the respondent's error as to the existence of a course of action against him. Consequently the failure of SMT to take any action to challenge the breach of fiduciary duty was the result of its error as to its right to do so. That plainly falls within the meaning of section 6(4)(a)(ii) of the Act: SMT failed to take action because of an error induced by the words or conduct of the respondent.

[26] Furthermore, the respondent continued in a fiduciary position during all this period, and accordingly remained subject to a duty to ensure that no conflict of interest existed between him and the company, or if it did to inform the company of the conflict. It is clear that he did not do so, either because he was unaware that SMT had any claim against him or because he decided to ignore any such claim or the possibility of such a claim. A fiduciary who has committed a breach of duty is under an obligation to inform his principal of the facts giving rise to the breach of duty, so that the principal can either authorize the breach or take action to remedy it. The respondent failed to do that, and that in itself amount to a further breach of fiduciary duty. The obligation to inform the company, as principal, of its right of action means that this is a particularly strong case for attributing the knowledge of the respondent to the company, and for attributing any error as to such a right of action to the company. It was not argued that the company had any right of action in respect of the

continuing breach of fiduciary duty through failing to inform it of the conflict of interest, but in our opinion such an argument might well have been successful. In that event the position of Miss Young, discussed in the following paragraph, would not have been relevant.

[27] The Lord Ordinary held that the defence in section 6(4)(a)(ii) was not available because Miss Young was also a director until May or June 2002, but it was not alleged that she had been fraudulent in her actings and no allegation of breach of fiduciary duty was made against her. We observe that that is not correct; the pleadings in the counterclaim specifically allege breach of fiduciary on Miss Young's part, and indeed on the facts found by the Lord Ordinary that seems an inescapable conclusion; she like the respondent was a director of SMT and received a bonus payment of £102,304 as part of the September transactions. The Lord Ordinary held that her knowledge must be attributed to SMT, and that in those circumstances it could not be shown that SMT was in error induced by words or conduct of the respondent, nor that any fraud on the part of the respondent induced it to refrain from making a claim. The basic proposition here appears to be that Miss Young knew about the transaction and could therefore have caused SMT to take action against the respondent. We think this highly unlikely. There is nothing in the facts found by the Lord Ordinary that suggests that Miss Young had any better knowledge of the right of action than the respondent had; before any such knowledge could be of assistance to the company it would require to be knowledge not only of the existence of the September transactions but also of the fact that those transactions amounted to a breach of fiduciary duty that gave rise to a right of action against the respondent.

[28] Even if that is not so, however, Miss Young ceased to be a director in June 2002. After that it cannot in our opinion be said that the company retained any knowledge that she might have had as to the right of action. A company has no mind of its own, nor any memory, other than the mind and memory of the individuals who are involved in the management of the company, either through the "directing mind and will" doctrine or as a result of the application of the principles of agency. Once Miss Young had gone, we find it impossible to conclude that any knowledge was retained; the only directing mind at that stage, and the only effective agent of the company, was the respondent. In this respect, the decision in *El Ajou* v *Dollar Land Holdings PLC*, *supra*, is readily distinguishable. The ultimate reason for that opinion appears to us to be that the defendant company, through its managing director, had knowledge about the fraud at the time when the transaction whereby the proceeds of fraud were paid to it was entered into. That in our opinion was the critical moment; if knowledge of the fraud existed then that was enough to infect the whole transaction. In the present case, by contrast, even if Miss Young was aware of SMT's right of action during the period in 2001 and early 2002 when she remained a director, that did not infect SMT's actions or failure to act thereafter. In *El Ajou* the dishonest transaction was forever tainted; in the present case what is in issue is a continuing failure to take action, which must depend on the actual state of mind of the officers of the company at any relevant moment.

[29] The September transactions were followed by the November dividend. The ground of action upheld by the Lord Ordinary in respect of the November dividend was that its payment was in breach of the directors' common law duty of care. Fiduciary duties are not relevant to that ground of action. We are nevertheless of opinion that the legal analysis is broadly the same as for the September transactions. The respondent clearly considered that the November dividend was justified at the time when it was paid, and there is no indication that his view changed subsequently. Consequently he would not consider that there was any ground of action by SMT against him (or Miss Young) at any time prior to the winding up of SMT. That was an error as to the existence of a right of action, and it is an error that clearly affected SMT as a result of the respondent's position as a director and, after Miss Young's resignation, as the directing mind and will of the company. Thus the failure to take action during the period down to the winding up was the result of error induced by words or conduct on the part of the respondent, and the exception in section 6(4)(a)(ii) is open to the company. The relevance of Miss Young's position as a director is exactly the same as with the September transactions, as discussed in the preceding paragraph.

Fraud

[30] Counsel for the reclaimers advanced a further argument, that the respondent's actings during the period between the September transactions and the November dividend and the winding up of the company amounted to fraud within the meaning of section 6(4)(a)(i), and that accordingly prescription did not run. This argument would only arise if the respondent was not in error as to the existence of a right of action against him on the part of SMT but rather realized that such a right existed but did nothing to cause SMT to assert it. On that basis, we are of opinion that this argument is correct. We should emphasize that the word "fraud" in section 6(4) does not appear to us to have the same meaning as in criminal law, where it means a false statement, made in the knowledge that it is false, which produces a practical result. The word rather denotes a significantly wider concept, akin to the meaning of "fraud" in the common law of bankruptcy, namely any device or other acting designed to disappoint the legal rights of creditors: see Erskine, Institutes, III.i.16; *McCowan* v *Wright*, 1853, 15 D 494. We reach that view in the light of the statutory context, namely the interruption of the period of prescription and the fundamental policy underlying section 6(4) as described in *BP Exploration*, *supra*, discussed above at paragraph [19]. That policy appears to us to demand that, in any case where a creditor is induced to refrain from taking steps to enforce a debt because of some deliberate action on the part of the debtor, the prescriptive period should not run. For this purpose it is immaterial whether the debtor's actings are dishonest, in the strict sense of that word; what is required is a deliberate acting on the part of the debtor that is intended to induce and does induce the creditor to refrain from asserting its rights. In such a case the creditor's failure to act is not his fault, but rather the fault of the debtor, and basic fairness demands that where an intentional act of the debtor is the reason for the delay the creditor should not be prejudiced.

[31] In the present case, if the respondent (and by extension Miss Young) was unaware of SMT's right to make a claim for breach of fiduciary duty, the result following the rules of attribution is that the company was in error as to its legal rights and section 6(4)(a)(ii) applies. If the respondent was aware of SMT's right to make a claim against him, his failure to alert to the company to its right was a deliberate contrivance to ensure that his breach of fiduciary duty was not challenged: see paragraph [24] above. That in our opinion falls within the concept of fraud, in the sense of a course of acting that is designed to disappoint the legal rights of a creditor, SMT. In our view that falls squarely within the underlying purpose of section 6(4), namely to excuse delay caused by the conduct of the debtor. As a result of the respondent's failure to draw attention to SMT's rights, SMT was induced to refrain from making a claim. It follows that either SMT's inaction was the result of an error induced by the actings of the respondent, or it was the result of the respondent's failure to inform the company of its rights ("fraud" in the technical sense described above). Either way, the prescriptive period does not run.

Conclusion

[32] We accordingly conclude that the conditions for the application of section 6(4)(a)(ii), or alternatively 6(4)(a)(i), are satisfied. In either event, prescription did not run during the period from either the September transactions or the November dividend until the winding up of SMT. That is sufficient for us to allow the reclaiming motion. We will accordingly recall the first and third sections of the interlocutor of the Lord Ordinary, in which he assoilzied the respondent from the conclusions of the counterclaim. We will further sustain the second and third pleas-in-law for the reclaimers in the counterclaim, repel the whole of the respondent's pleas-in-law, and pronounce decree in terms of the first of the conclusions of the counterclaim, to the effect that the respondent is obliged to make payment to the reclaimers of a total sum amounting to £786,649.