ILLEGALITY AND ATTRIBUTION: WHERE ARE WE NOW?

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INTRODUCTION

1. I am delighted to speak to you all this evening on subjects that have occupied the Supreme Court on several occasions in recent years: illegality and attribution. In particular I will consider the Supreme Court's decision in *Singularis Holdings Ltd. (in liquidation) v. Daiwa Capital Markets Europe Ltd.* [2019] UKSC 50, [2019] 3 WLR 997 and its impact on the House of Lords decision in *Stone & Rolls Ltd. v. Moore Stephens* [2009] AC 1391.

2. Time is short and each aspect of this talk could keep us hear for an hour or more. I will therefore concentrate on a handful of important topics, mindful of the fact that the speaker who stands between his or her audience and drinks is running a dangerous risk. My note contains references to relevant cases.

3. I will review first of all what we mean by "attribution" and "illegality". I will then discuss the decision in *Singularis*, and its impact on *Stone & Rolls*. I will then offer some conclusions. This talk does not constitute legal advice on any particular fact or matter.

ATTRIBUTION

4. Attribution describes the process of holding a company responsible for something done by someone else by attributing that person's acts and omissions to the company. To recap on some of the principles underlying this process:

a. A company is its own legal person, separate from its directors and members: *Salomon v. A. Salomon & Co. Ltd.* [1897] AC 22. This starting point was described as one of the fundamental facts on which company law and economics have operated for over 100 years in *Petrodel Resources Limited v. Prest* [2013] UKSC 34, [8] per Lord Sumption; cf. section 16 of the Companies Act 2006.

b. However a company must act through human beings. As Viscount Haldane LC said in *Lennard's Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.* [1915] AC 705, 713: "*…a corporation is an abstraction. It has no mind of its own any more than it has a body of its own...*".

c. The company normally acts through its directors. On ordinary principles of agency, their acts and omissions are treated as the acts or omissions of the company, so that the company is liable for what the directors do or fail to do.

d. Directors do not normally bear personal liability for what the company does, particularly if they are only doing things within the normal scope of their authority or role.

e. Directors can incur personal liability in tort, or more widely, but there is a clear legal policy of restricting liability: *Standard Chartered Bank v. Pakistan National Shipping Corp. (Nos 2 and 4)* [2003] 1 AC 859 (deceit); *Williams v. Natural Life Health Foods Ltd.* [1998] 1 WLR 830 (negligent misstatement); but see *MCA Records Inc. v. Charly Records Ltd.* [2001 EWCA Civ 1441, [2003] 1 BCLC 93 and *Rainham Chemical Works Ltd. v. Belvedere Fish Guano Co. Ltd.* [1921] 2 AC 465 ("procuring and directing" the company to commit the torts in question).

f. Members of the company stand outside these principles. They are entitled to the rights conferred on them by the companies legislation and the company's constitution, but do not own the company's property and are not normally agents of the company. It is only in very rare situations that the court can look through the company to fix liability on a member by means of a thoroughly unhelpful metaphor, "piercing the corporate veil": *Petrodel v. Prest, supra*.

g. Issues of attribution are particularly important in the context of one-man companies. If there is a single shareholder and director who controls everything, is there any line to draw between his acts and omissions and those of the company?

ILLEGALITY

5. For today's purposes illegality arises arises where a defendant wants to defeat a claim because the claimant has done something unlawful or illegal which is part and parcel of the claim: the "illegality defence".

6. It used to be expressed in a Latin phrase: "*ex turpi causa non oritur actio*", no cause of action arises from a disgraceful or immoral consideration. A central test eventually emerged: the claim would be defeated if the claimant needed to rely on or prove something illegal, such as an illegal contract: *Tinsley v. Milligan* [1994] 1 AC 340.

7. The Supreme Court recently reviewed illegality in *Patel v. Mirza* [2017] AC 467.

8. Mr Patel agreed to pay £620,000 to Mr Mirza on the basis that Mr Mirza would use it to bet on the price of shares, using insider information that he was expecting. In other words there was a conspiracy to

commit insider dealing contrary to section 52 of the Criminal Justice Act 1993.

9. The inside information was not forthcoming and the bets were never placed. Mr Patel wanted his money back and claimed in restitution. Mr Mirza refused to give it to him because he said that the claim was barred by illegality: Mr Patel would need to prove the agreement in order to demonstrate that the purpose for which the money was paid over had failed, giving rise to the obligation to restore it to Mr Patel. 9 justices of the Supreme Court heard the appeal. They rejected the traditional touchstone of how the court assessed whether illegality barred the claim – whether it was necessary to plead the illegal agreement in order to succeed in accordance with *Tinsley v. Milligan*. By a majority of 6 to 3 they adopted a new test set out by Lord Toulson JSC in the leading judgment at [2017] AC 467, [120]:

> "*The essential rationale of the illegality doctrine is that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system…In assessing whether the public interest would be harmed in that way, it is necessary (a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim, (b) to consider any other relevant public policy on which denial of the clam may have an impact and (c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts.*"

10. Applying these principles, Mr Patel's claim succeeded. The purpose of prohibiting insider dealing was upholding the integrity of the markets. That purpose had not been transgressed, because no insider dealing had taken place. Other public policy considerations did not make a difference. Denying the claim would be a wholly disproportionate response. All Mr Patel wanted was his money back.

11. Where an illegality defence arises, the court will take 3 steps:

a. First, identify the purpose of the legal rule that has been contravened and ask whether that purpose would be enhanced by denying the claim?

b. Secondly, are there any other relevant public policies which would be affected by denying the claim?

c. Thirdly, is denying the claim a proportionate response to the illegality?

SINGULARIS

The facts

12. The facts of *Singularis Holdings Ltd. (in liquidation) v. Daiwa Capital Markets Europe Ltd* [2019] UKSC 50, [2019] 3 WLR 997 are straightforward:

a. Mr Al Sanea was a Saudi billionaire. He was the sole shareholder and a director of Singularis Holdings Ltd ("Singularis"), incorporated as a vehicle for his wealth. There were 6 other directors, who were all experienced and reputable businessmen. Mr Al Sanea was, however, in sole charge, acting as chairman, president, and treasurer, with numerous powers of attorney.

b. Daiwa is the London subsidiary of a Japanese bank.

c. The assets of Singularis were shares in various entities. The shares were sold with the result that Singularis's account held cash of US$ 204 million.

d. Singularis was in financial difficulty and those difficulties were well known to Daiwa's management and compliance teams, who had to consider them for their own internal purposes and in the context of restructuring Singularis's facilities. Mr Al Sanea was connected to a multi-billion pound business empire in Saudi Arabia (the Saad Group), whose financial difficulties were widely reported in the UK press. His wife's family and its multi-billion pound business empire, were also in serious, well-publicised difficulty.

e. Nonetheless Mr Al Sanea gave instructions for Daiwa to make 8 payments, by which all its cash was paid away to his order. He did so by reference to documents and instructions which were on their face suspicious.

f. Thereafter Singularis entered voluntary liquidation in the Cayman Islands. Shortly after that it was placed in compulsory liquidation, on application of one of its creditors.

13. The liquidators sought the recovery of the money paid away by Daiwa on the basis that Daiwa had breached the duty of care owed by a bank to its customer to refrain from executing an instruction to make a payment out of the customer's account where it had reasonable grounds to believe that a fraud was being carried out. The liquidators alleged that Mr Al Sanea had committed a fraud on the company, and that Daiwa should have realised that this was a possibility, investigated the position and stopped the payments. The liquidators said that Daiwa was liable to reimburse the company for what it had lost through the fraud of Mr Al Sanea, its own controlling mind. There was also a claim in dishonest assistance against Daiwa, focusing on the conduct of two of Daiwa's employees.

14. Daiwa argued that Singularis was a "one man company" and fraud by Mr Al Sanea was to be treated as fraud by Singularis. Three consequences followed:

a. Singularis was complicit in the fraud and could not bring a claim arising from its own wrong – the illegality defence.

b. Singularis has caused it own loss and Daiwa's acts and omissions had made no difference – the causation defence.

c. Daiwa had an equal and countervailing claim in deceit, such that Singularis's claim failed – the circularity of action defence.

<u>The *Quincecare* duty</u>

15. It is worth digressing for a moment to consider the duty of care alleged by the liquidators against Daiwa. It arises from the judgment of Steyn J in *Barclays Bank Plc v. Quincecare Ltd*. [1992] 4 All ER 363, 375 to 377. The chairman of Quincecare took for himself £340,000 of a £400,000 loan from Barclays to the company. The bank sought to recover this sum from the company. The claim succeeded because the bank had no reason to suspect fraud on the chairman's part. The case is significant for Steyn J's description of the bank's duty of care to its customer:

> "*Primarily, the relationship between a banker and customer is that of debtor and creditor. But quoad the drawing and payment of the customer's cheques as against the money of the customer's in the banker's hands the relationship is that of principal and agent: see* Westminster Bank Ltd v Hilton (1926) 43 TLR 124, 126, *per Lord Atkinson . . . Prima facie every agent for reward is also bound to exercise reasonable care and skill in carrying out the instructions of his principal:* Bowstead on Agency, 15 th ed (1985), p 144. *There is no logical or sensible reason for holding that bankers are immune from such an elementary obligation. In my judgment it is an implied term of the contract between the bank and the customer that the bank will observe reasonable skill and care in and about executing the customer's orders . . .*
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> *Given that the bank owes a legal duty to exercise reasonable care in and about executing a customer's order to transfer money, it is nevertheless a duty which must generally speaking be subordinate to the bank's other conflicting contractual duties. Ex hypothesi one is considering a case where the bank received a valid and proper order which it is prima facie bound to execute promptly on pain of incurring*

> *liability for consequential loss to the customer. How are these conflicting duties to be reconciled in a case where the customer suffers loss because it is subsequently established that the order to transfer money was an act of misappropriation of money by the director or owner? If the bank executes the order knowing it to be dishonestly given, shutting its eyes to the obvious fact of the dishonesty, or acting recklessly in failing to make such inquiries as an honest and reasonable man would make, no problem arises: the bank will plainly be liable. But in real life such a stark situation seldom arises. The critical question is: what lesser state of knowledge on the part of the bank will oblige the bank to make inquiries as to the legitimacy of the order? In judging where the line is to be drawn there are countervailing policy considerations. The law should not impose too burdensome an obligation on bankers, which hampers the effective transacting of banking business unnecessarily. On the other hand, the law should guard against the facilitation of fraud, and exact a reasonable standard of care in order to combat fraud and to protect bank customers and innocent third parties. To hold that a bank is only liable when it has displayed a lack of probity would be much too restrictive an approach. On the other hand, to impose liability whenever speculation might suggest dishonesty would impose wholly impractical standards on bankers. In my judgment the sensible compromise, which strikes a fair balance between competing considerations, is simply to say that a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has reasonable grounds (although not necessarily proof) for believing that the order is an attempt to misappropriate the funds of the company . . . And, the external standard of the likely perception of an ordinary prudent banker is the governing one. That in my judgment is not too high a standard . . .*
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> *Having stated what appears to me to be the governing principle, it may be useful to consider briefly how one should approach the problem. Everything will no doubt depend on the particular facts of each case. Factors such as the standing of the corporate customer, the bank's knowledge of the signatory, the amount involved, the need for a prompt transfer, the presence of unusual features, and the scope and means for making reasonable inquiries may be relevant. But there is one particular factor which will often be decisive. That is the consideration that, in the absence of telling indications to the contrary, a banker will usually approach a suggestion that a director of a corporate customer is trying to defraud the company with an initial reaction of instinctive disbelief . . . it is right to say that trust, not distrust, is . . . the basis of a bank's dealings with its customers. And full weight must be given to this consideration before one is entitled, in a given case, to conclude that the banker had reasonable grounds for thinking that the order was part of a fraudulent scheme to defraud the company."* (My emphasis.)

The judgments

16. At first instance [2017] Bus LR 1386, Rose J rejected the claim in dishonest assistance, but found for the liquidators on the *Quincecare* duty, holding Daiwa liable to restore an amount equal to what Mr Al Sanea had caused Singularis to transfer, less 25% for contributory negligence. The Court of Appeal affirmed her decision [2018] EWCA Civ 84, [2018] 1 WLR 2777. The Supreme Court dismissed Daiwa's appeal.

17. Lady Hale gave the sole judgment with which Lord Reed, Lord Lloyd-Jones, Lord Sales JJSC and Lord Thomas of Cwmgiedd agreed. She accepted the liquidator's counsel's submission that "*this case is in fact bristling with simplicity*": [1] and [39]. In summary:

    a. None of the judge's findings of fact was challenged. It was therefore established that Daiwa was in breach of the *Quincecare* duty because any reasonable banker would have realised that there were "*many obvious, even glaring, signs that Mr Al Sanea was perpetrating a fraud on the company…*". As Rose J put it at [202] of her judgment: "… *'Everyone recognised that the account needed to be closely monitored…But no one in fact exercised care or caution or monitored the account themselves and no one checked that anyone else was actually doing any exercising or monitoring either'*." [11]

    b. Having established that there was an incontrovertible breach of the *Quincecare* duty, the question was did Daiwa have a defence? [12] So far as illegality was concerned, the answer was no. Returning to the test set out in *Patel v. Mirza*, Lady Hale agreed with the judge's reasoning [21], as follows:

        i. Stage 1: Mr Al Sanea had committed a fraud on Singularis and had provided false documents and information to Daiwa. What was the purpose behind the prohibitions on company officers breaching their fiduciary duties and providing false material to a bank? The answers were obvious: to protect companies from becoming the victim of the wrongful exercise of power by officers of the company; to protect the bank from being deceived; and to protect the company from having its funds misappropriated. Would the purposes be enhanced by denying the claim? Denying the claim would protect Daiwa, but Daiwa was already protected by only making it liable if it breached the *Quincecare* duty, which it obviously had. The purposes relating to the company would not be enhanced by denying the claim. *Singularis*, [16].

ii. Stage 2: The public policy of encouraging financial institutions to join the fight against financial crime and money laundering was relevant. Denying the claim would not in fact undermine that policy. *Singularis*, [17].

iii. Stage 3: Denying the claim would be a disproportionate response to the wrongdoing on the part of Singularis. Reducing the damages for contributory negligence struck the right balance. *Singularis*, [18].

iv. The causation defence failed: "*…the purpose of the Quincecare duty is to protect a bank's customers from the harm caused by people for whom the customer is, one way or another, responsible. Hence* [the liquidators' counsel] *argues that the loss was caused, not by the dishonesty, but by Daiwa's breach of its duty of care. Had it not been for that breach, the money would still have been in the company's account and available to the liquidators and creditors…The* *fraudulent instruction to Daiwa gave rise to the duty of care which the bank breached, thus causing the loss." Singularis,* [23].

c. The circularity defence failed for reasons bound up with Lady Hale's consideration of attribution.

Attribution and *Stone & Rolls*

18. Daiwa's case on attribution overlapped with its case on the other 3 defences. Daiwa argued that Mr Al Sanea was the directing mind and will of Singularis; it was effectively a "one man company". His fraud should be attributed to Singularis, such that Singularis had no claim.

19. Given that companies have their own separate legal personality and can only act through human agency, "*the issue is **when** the acts and intentions of real human beings are to be treated as the acts and intentions of the company*" [27] (my emphasis). The classic exposition of attribution was found in *Meridian Global Funds Management Asia Ltd. v. Securities Commission* [1995] 2 AC 500, which described 3 levels of attribution: first, the company's constitution; secondly, the ordinary principles of agency and vicarious liability; thirdly, particular rules of law that treated the company as bound by the director's actions.

20. The next step in the analytical path was *Stone & Rolls*. Mr Stojevic owned and controlled Stone & Rolls Ltd. He procured it to commit a fraud on a number of banks. One of the banks sued the company in deceit and it went into liquidation. The company then sued its auditors, alleging that they negligently failed to detect Mr Stojevic's fraud. The auditors applied to strike out the claim on the basis that Mr Stojevic's fraud was to be attributed to the company. The trial judge refused, because the fraud was the "very thing" the auditors were supposed to find out. The Court of Appeal allowed an appeal on the

old fashioned approach to illegality: in order to succeed, the company had to prove and rely upon Mr Stojevic's fraud, which gave rise to the illegality defence. The House of Lords upheld that conclusion, by a majority: Mr Stojevic's knowledge was to be attributed to the company, because he was its "directing mind and will".

21. *Stone & Rolls* proved controversial. It was extensively analysed in *Bilta (UK) Ltd v. Nazir (No 2)* [2016] AC 1. This case concerned a claim by liquidators against directors and others for conspiracy to defraud the company. The claim was defended on the basis that the directors' fraud was to be attributed to the company, which could not then claim against the other defendants, relying upon its own illegality to do so. The panel of 7 justices unanimously rejected this approach: where a company had been the victim of wrongdoing by its directors, the wrongdoing of the directors cannot be attributed to the company as a defence to the claim against the directors or their fellow conspirators by the company's liquidator for loss arising from the wrongdoing. The point of principle was that "*…the key to any question of attribution was always to be found in considerations of the context and the purpose for which the attribution was relevant.*" But the answer might differ depending on whether the court was considering the relationship between the company and its agents on the one hand, or between the company and third parties on the other hand. *Singularis*, [30].

22. In *Bilta*, Lord Toulson and Lord Hodge thought that *Stone & Rolls* had no majority *ratio decidendi*. Lord Sumption thought that it was authority for 3 propositions. Lord Neuberger, Lord Clarke and Lord Carnwath agreed with only two of these points. You can well understand why Lord Neuberger said that the case should "*be put 'on one side in a pile and marked 'not to be looked at again'.*" *Singularis*, [31 to 32].

23. Lady Hale observed that *Stone & Rolls* and the Supreme Court's decision in *Bilta* had been taken as establishing a rule of law that the dishonesty of the controlling mind in a one man company could be attributed to the company with all that entails, whatever the context and purpose of the attribution in question. She agreed with Rose J that there was no such rule of law and that in any case, Singularis was not a one man company in this sense. [33 to 34] Lady Hale agreed with Rose J that, following *Bilta*, "… *'the answer to any question whether to attribute the knowledge of the fraudulent director to the company is always to be found in consideration of the context and the purpose for which the attribution is relevant'. I agree and, if that is the guiding principle, then Stone & Rolls can finally be laid to rest.*" [34]

24. Accordingly Lady Hale rejected Daiwa's submission that Mr Al Sanea's fraud was to be attributed to Singularis, thus defeating the claim. Daiwa had breached its own *Quincecare* duty. If Mr Al Sanea's fraud was attributed to Singularis, the *Quincecare* duty would be denuded of value in cases where it was most needed. There would in fact be no *Quincecare* duty at all. [35] This was not a claim against auditors and comparisons with such claims were not helpful [36]. Neither was it helpful to compare the position of a company to the position of an individual [37]. The case was, indeed, "*bristling with simplicity*" [39]. There was no basis for attributing Mr Al Sanea's fraud to Singularis.

CONCLUSIONS

25. If you come across a claim by insolvency officeholders against the company's directors, advisers or persons who owed the company a duty of care, such as a bank in a *Quincecare* situation, bear in mind the following points.

26. First, if there is an allegation of illegality, apply the test in *Patel v. Mirza*. What is the illegality? What is the purpose of the rule declaring the relevant acts illegal? Will that purpose be enhanced by denying the claim? What other policy considerations apply? Is denying the claim a proportionate response to the wrongdoing?

27. Secondly, who is bound up with the illegality? Are you dealing with a sole director-shareholder or a group of directors/ agents/ fellow conspirators? Who is innocent and what role have they been playing?

28. Thirdly, when considering attribution, apply the test in *Meridian Global:* consider the company's constitution and the general principles of agency and vicarious liability which will usually supply the answer, plus, in exceptional cases, any specific rules of law. Following *Bilta* and *Singularis* consider also the context and the purpose for which the attribution is relevant.

29. Fourthly, if you are dealing with a one-man company, as we often do, there is no special rule by which misconduct by the sole "directing mind and will" is always attributed to the company. *Stone & Rolls* is not to be followed, even though it is difficult to think of situations where the knowledge of a one-man director-shareholder should not be attributed to the company.

30. The wings of the illegality defence have been clipped back further and the delineation of each party's role has crucial importance for working out whether wrongdoing may be attributed to a company so as to defeat a claim brought in right of the company.

31. There will no doubt be a wealth of experience in this room concerning the illegality defence and attribution. I look forward to hearing about it over drinks.

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Simon is ranked as a leading junior in company, partnership and insolvency matters, praised as *"an outstanding Chancery barrister who is a QC and High Court judge in the making"* who is *"excellent at everything and should be a silk already"* (Legal 500). His practice also encompasses contractual disputes of all kinds, bank recovery proceedings, professional negligence and property disputes, together with asset tracing and freezing orders. Very often he appears without a leader against QCs. He practices mainly in the Commercial Court and Chancery Division and has acted in the Supreme Court and Court of Appeal (in the latter with and without a leader).

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Simon is a leading junior in insolvency disputes (Legal 500, band 4). He advises and represents officeholders, debtors and creditors in all manner of corporate and personal insolvency cases. Simon has particular expertise in clawback claims against directors and regularly defends officeholders in challenges to their appointments and claims for misfeasance. He has conducted or defended numerous applications under the Cross-Border Insolvency Regulations and the EU Insolvency Regulation. He has many years' experience of cross-border insolvencies of extreme complexity and high value, starting with T&N/ Federal-Mogul, where he was junior counsel to the administrators. Simon edits the restructuring chapter of Gore-Browne on Companies and has advised debtors and creditors on proposed voluntary arrangements, including landlords considering retail CVAs.

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