COMMERCIAL AND INSOLVENCY WEBINAR

A SHIFT OF WEALTH: SECURITY OVER INTELLECTUAL PROPERTY

ATTRIBUTION AND ILLEGALITY

WHERE ARE WE NOW?

TO ADJUDICATE OR NOT TO ADJUDICATE? *BRESCO* IN THE SUPREME COURT

MADELEINE HEAL

SIMON JOHNSON

AMIT GUPTA

By Zoom

13 July 2020

SECURITY OVER INTELLECTUAL PROPERTY – ECONOMIC WEALTH IN APPS

MADELEINE HEAL

Biography

Madeleine has over 20 years' experience of commercial litigation involving intellectual property infringement and technology and has appeared in many trials involving IP, media rights and data protection. More recently she has been instructed in commercial and insolvency matters regarding technology, both on and offshore. She has been ranked in *Chambers & Partners* and *Legal 500* for the last 18 years.

Enforcing security over Patents, Trade Marks, Copyright and Designs

1. It is now almost beyond cliché that economic wealth is increasingly taking the form of knowledge, patents for inventions and trade marks for brands which may find protection in statutory intellectual property rights such as copyright, patents and registered trade marks respectively. Trade Secrets are protected by the common law. All are capable of being the subject of security.

2. "Intellectual property" is a term used to describe a range of statutory and common law monopoly rights over what can loosely be described as the product of the human mind. Intellectual property rights (IPR) are "property" in the sense that the rights holder or "owner" is entitled to bring an action to restrain infringing use of that property by a defendant. In that sense, most IPRs are what are called 'negative' rights. They do not grant a positive right to do anything, only to prevent others from doing so. As such they can be said to be worth what the owner is willing to commit to enforcing or protecting them.

3. The role of intellectual property and intangible assets in facilitating business finance over the last even as little as 5-10 years, has seen a meteoric rise. This rise is likely to be placed into sharp relief as lockdowns lift around the

world and lenders seek to enforce their securities over valuable IP 'intangibles'.

4. Where full fixed and floating security is taken over the assets of a company, intellectual property rights are often incidentally included in the classes of assets over which a debenture seeks to create security. There are other transactions where security over IPR constitutes the primary, sometimes the only security, for example in cases involving film financing and those involving computer software, which includes novel internet applications such as social networking sites or "apps".

5. The source code underpinning an app, for example, is written in computer language or code and is a 'literary work' for the purposes of the relevant UK statute, the Copyright Designs and Patents Act 1988. It is the copyright that is valuable.

6. IPRs are intangible and are treated with more caution by commercial lenders than other intangibles such as book debts.

7. IPRs are time limited: for example, in the case of copyright in a literary work, the monopoly lasts for the life of the author plus another 70 years. Registered Trade Mark rights last for as long as the renewal fees are paid and the mark is not struck off the register, for example, for non-use. IPRs are also territorial. Each country has its own trade marks register for example, and unless registered under the regime of an economic bloc such as the EU, the owner of a brand must register his trade mark in each country individually for the goods and services in respect of which he uses the mark, and pay renewal fees in each country to maintain them.

8. Some IPRs may change over time. For example, the 'literary work' underpinning an app may be developed and over-written many times after security over the first copyright in a work is given, perhaps creating new copyrights. Are they included in the security? What about other IPRs that only come into existence in the future after the security is given, for example, rights in the film which has been financed? Certain international aspects of intellectual property may need to be considered when effecting security arrangements. A mechanism may need to be established for dealing with existing and future agreements to exploit the IPR as mortgaged property.

9. The various statutory regimes which are the foundation of intellectual property rights are subject to interpretation and uncertainty. The prospects of success of a claim involving the interaction between statutory law and other areas of commercial law, such as insolvency law, are not easy to predict.

10. Intellectual property rights registered on an intellectual property register such as the UK Register of Patents (for inventions) or the UK Trade Marks Register (for brands), may not provide the same level of certainty as to the existence of prior inconsistent security rights as would, say, the register of company charges. This is because a rights owner may commit invalidating acts and/or there may be a successful challenge to registration of the IPR in question.

11. The law of secured interests has had to be moulded around intellectual property rights. The UK has a strong and well established judicial system for protecting IP assets, presided over by specialist IP judges, which offers a court for IP claims of lesser value (the Intellectual Property Enterprise Court) and the Business and Property Court, Intellectual Property List for larger value disputes, both of which courts are part of the Chancery Division of the High Court, and presided over by specialist judges. Most IP disputes are assigned to those courts and applications for urgent interim relief in respect of them are common and dealt with quickly. A review of online legal sources shows that the IP courts of England and Wales have remained active over lockdown.

12. Notwithstanding the conceptual differences between intellectual and other forms of property, there is no separate conceptual apparatus for the taking of security over IPR. Lenders use the standard forms of security interests available under English law, including the mortgage, the pledge and the charge (both fixed and floating), subject to any statutory modification.

13. That brings me to the few words I want to say today about charges over intellectual property rights.

14. Imagine a group of related companies which do business entirely by way of an App that is marketed under a registered trade mark, nominate one of their number, shall we say for tax reasons, to be the owner of the IPR. It so happens that the IP subject matter was written or invented by employees of

the company nominated and so it is that company's IPR to begin with. The company nominated remains the holder or registered proprietor of the group's trade mark, the registrant of its internet domain name and the owner of copyright in the source code that underpins the App. These are the group's 'crown jewels'. One day, the group needs finance and borrows from its pension fund, secured by a fixed and floating charge in favour of the pension fund over the intellectual property of the IP rights owning company. The charge is duly registered.

15. The IP rights holder goes into liquidation and joint liquidators are appointed. The directors who are common to all the other companies in the group as well as the company in liquidation, and the pension fund, execute an assignment of the IPR to one of the other group companies that is not in liquidation, so that they can continue to use the crown jewels and do business via the app.

16. However, the registered charge over the IPR in favour of the pension fund conferred of necessity only an equitable interest in the pension fund over the IPR. That equitable interest may be enforced by the pension fund only by an application for an order of the court, and the court subsequently granting an order to that effect. The pension fund cannot dispose of or deal with the IPR otherwise.

17. Whereas a legal mortgage over intellectual property is an absolute assignment of legal title such that the mortgagee acquires a proprietary interest because it becomes the legal owner of the IPR, a chargee's interest exists only by virtue of the equitable remedies available upon its application to the court. There may be many sound commercial reasons why a charge is taken over the IPR rather than a mortgage but there is not time to go into those today. Where the pension fund has made no such application to the court or been granted an order, the Directors' and pension fund's assignment of the IPR to another company in the group is void, and the liquidators may proceed to sell the IP assets.

18. A legal charge over intellectual property does not benefit from the provisions of the Law of Property Act 1925. The pension fund is unable to take possession of or to sell the IPR or to receive any profits or royalties from it without an order of the court. The charge is a lesser form of security

because it does not assign the legal title to the IPR to the lender. It is an encumbrance only, even if it is a fixed charge.

19. Copyright and registered trade marks may be transferred by operation of law upon insolvency as may other intangibles. In the example, all powers of the Directors in all intellectual property of the company in liquidation were acquired by the Joint Liquidators upon their appointment, including the power to seek a vesting order. After their appointment, the other group companies' use of the trade mark, domain name, confidential information, copyright and website under the purported assignment or otherwise are infringing acts and amount to collusion to defraud the Joint Liquidators and misfeasance by the Directors of the company in liquidation.

20. The interaction of intellectual property and insolvency law requires expertise in registered and unregistered intellectual property rights as well as insolvency expertise. Urgent applications may need to be made to a court by rights holders, lenders and insolvency professionals alike to protect the intellectual property. IPRs can be perishable or lost completely in the wrong hands.

21. Novel approaches may be required to enable the lender to take effective economic control of the rights in question in the event of default. For example, escrow agreements in respect of computer software source codes may be used to provide the security holder with rights to access the source code in the event of default, allowing the lender to continue to exploit the escrow material. Such rights are contractual and not proprietary in nature and will involve an independent third party acting as escrow agent for the company on commercial terms and on the instructions of the lender. They may need to be enforced.

22. Lenders may rely on other non-proprietary mechanisms as important elements of a security package over IPR, including no-assignment and no-dealing covenants by rights holders, although such covenants are likely to be unenforceable against third party purchasers for value without notice.

Madeleine Heal
Enterprise Chambers
T: 020 7405 9471
E: madeleineheal@enterprisechambers.com

ATTRIBUTION AND ILLEGALITY

WHERE ARE WE NOW?

SIMON JOHNSON

Biography

Simon Johnson is ranked as a leading junior in company and insolvency law. He advises company boards, directors, shareholders, banks, other creditors and insolvency office-holders on a wide range of matters in these fields. Simon's practice also encompasses contractual disputes of all kinds, bank recovery proceedings, professional negligence and property disputes. Very often he appears without a leader against QCs. He practises 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).

What the Directories Say:

"A strong all-rounder, with a talent for getting to the heart of the issues."

"He is excellent at everything and should be a silk already."

"An outstanding Chancery barrister who is a QC and High Court Judge in the making."

"A great court presence; he is tenacious yet always has a very pleasant manner about him."

"Very technically able in his area and able to translate that into practical steps."

Simon is a contributor to Gore-Browne on Companies (chapter 46, restructuring) and PLC (company law and insolvency). He lectures and publishes articles on matters of interest arising in his practice.

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: attribution and illegality. 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. 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

3. Attribution is holding a company responsible for something done by someone else by attributing that person's acts and omissions to the company. To recap:

    a. A company is its own legal person, separate from its directors and members: *Salomon v. A. Salomon & Co. Ltd.* [1897] AC 22.[1]

    b. However, a company must act through human beings: "*…a corporation is an abstraction. It has no mind of its own any more than it has a body of its own…*".[2]

    c. The company normally acts through its directors. On ordinary principles of agency, their acts and omissions are treated as the

---

[1] 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.

[2] *Lennard's Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.* [1915] AC 705, 713, per Viscount Haldane LC.

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.[3]

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*.

4. 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 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".

---

[3] *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).

6. It used to be expressed in a Latin phrase: "*ex turpi causa non orituractio*", 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. The result of that case is that 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?

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.

SINGULARIS

The Facts

11. The facts of *Singularis*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.[4]

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.

12. 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.

---

[4] 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.

13. 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 its 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.

The Quincecare Duty

14. 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.

15. Steyn J held that it was an implied term of the contract between the bank and its customer that the bank would execute the customer's orders with reasonable skill and care. The bank would breach this duty if it was "put on inquiry" in the sense of having reasonable grounds for believing that the order was an attempt to misappropriate money from the company. The test for whether the bank is put on inquiry is the objective one of the ordinary, prudent banker. In the absence of "*telling indications to the contrary*", it would often be decisive that a banker would usually view an allegation that a director is trying to defraud the company with instinctive disbelief. The court would give full weight to the consideration that trust, rather than distrust, is the basis of a bank's dealings with its customer, before concluding that the banker had reasonable grounds for thinking that the order in question was part of a fraud on the company.

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]. A summary follows.

18. 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…*". [11] [5]

19. 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:

    a. 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

[5] 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'.*"

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].

b. 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].

c. 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].

20. 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].

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

ATTRIBUTION AND *STONE & ROLLS*

22. 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.

23. 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.

24. 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".

25. *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].

26. In *Bilta*, the Supreme Court was divided on what *Stone & Rolls* decided.[6] You can well understand why Lord Neuberger said in *Singularis* that the case should "*be put 'on one side in a pile and marked 'not to be looked at again'.*" [31 to 32].

27. 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]

28. 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*

---

[6] 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.

simplicity" [39]. There was no basis for attributing Mr Al Sanea's fraud to Singularis.

CONCLUSIONS

29. 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.

30. 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?

31. 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?

32. 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.

33. 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.

34. 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.

Simon Johnson

Enterprise Chambers
T: 020 7405 9471
E: simonjohnson@enterprisechambers.com

TO ADJUDICATE OR NOT TO ADJUDICATE?

BRESCO IN THE SUPREME COURT

AMIT GUPTA

Biography

Amit specialises in all commercial and contentious insolvency disputes (often acting for insolvency practitioners, banks, directors and individuals) including cases that cross into construction and adjudications. He practiced in the Midlands for over a decade before moving to London.

What the Legal 500 and Chambers and Partners say about him:

> *"He is a polished advocate."*
>
> *"He is brilliant in front of a judge."*
>
> *"Approachable, knowledgeable and commercially aware. "*
>
> *"Outstandingly responsive and academically superb, as well as a persuasive advocate. Extremely responsive and academically superb, he is a fierce advocate who is always willing to go the extra mile. Amit is very technical, excellent with clients and highly commercial."*
>
> *"An extremely impressive junior who has established an excellent reputation in commercial litigation, demonstrating particular strength in insolvency matters."*

INTRODUCTION

1. This is one of the most significant decisions of the year, particularly because it bridges two significant (and quite different) industries.

2. In short, the Supreme Court concluded that:

a. An adjudicator to whom a dispute is referred by a party in liquidation **does have jurisdiction** to determine the dispute, and

b. **Such an adjudication is not futile** because, whether or not the decision will ultimately be enforceable, adjudication is a valid and useful form of ADR in its own right.

BACKGROUND

3. In 2015, Bresco became insolvent and entered into voluntary liquidation. Lonsdale's position was that Bresco had abandoned the project prematurely, resulting in the need to spend £325,000 on replacement contractors. In contrast, Bresco alleged it was owed £219,000 in respect of unpaid fees plus damages for lost profits.

4. In 2018, Bresco referred the latter claim to an adjudicator. Lonsdale objected on the basis that any such claim was cancelled out by Lonsdale's cross-claim by operation of insolvency set-off. Fraser J in the TCC granted an injunction halting the adjudication (accepting both of Lonsdale's jurisdiction and futility arguments).

THE COURT OF APPEAL JUDGMENT

5. Lord Justice Coulson gave the leading judgment and concluded that there was no absolute jurisdictional bar preventing an insolvent claimant commencing and pursuing an adjudication, however he found there existed a "*fundamental incompatibility*" between the adjudication regime on the one hand and the insolvency set-off regime on the other. As to the latter, while the adjudicator would have jurisdiction, the court held that an adjudication would be futile because it could never reach a position where the ultimate mutual account could be determined as a result of the adjudication. This, together with difficulties arising out of security, would mean that any adjudication decision in the circumstances would never be enforced:

"37. I consider that there is a basic incompatibility between adjudication and the regime set out in the Rules. The former is a method of obtaining an

improved cashflow quickly and cheaply. The latter is an abstract accounting exercise, principally designed to assist the liquidators in recovering assets in order to pay a dividend to creditors. Rule 14.25 envisages the taking of a detailed account as between the company and the creditor, and the careful calculation of a net balance one way or the other, or quantifying the company's net claim against a creditor. By contrast, adjudication is a rough and ready process which Dyson J (as he then was) said in Macob Civil Engineering Ltd v Morrison Construction Ltd [1999] BLR 93 was "likely to result in injustice". They are therefore very different regimes."

THE SUPREME COURT

The remit

6. By virtue of the appeal and the cross-appeal, the same issues were before the Supreme Court. The Supreme Court judges were unanimous, with Lord Briggs giving the leading judgment; he summarised the dispute as follows:

"it is argued on this appeal that, if there are cross-claims between parties to a construction contract and one of them is in liquidation, then there can be no adjudication of any dispute between them about those cross-claims even if, but for the liquidation and the existence of cross-claims, one or more of those disputes would fall within the right to refer to adjudication conferred by section 108".

The jurisdiction argument

7. The argument was this: insolvency set-off replaces the former cross-claims with a single claim for the net balance meaning that there is no longer a dispute under the construction contract, so that the adjudicator's statutory jurisdiction is not engaged.

8. Rule 14.25 of the Insolvency (England and Wales) Rules 2016 provide as follows:

"14.25 Winding up: mutual dealings and set-off

(1) This rule applies in a winding up where, before the company goes into liquidation, there have been mutual dealings between the company and a creditor of the company proving or claiming to prove for a debt in the liquidation.

(2) An account must be taken of what is due from the company and the creditor to each other in respect of their mutual dealings and the sums due from the one must be set off against the sums due from the other.

(3) If there is a balance owed to the creditor then only that balance is provable in the winding up.

(4) If there is a balance owed to the company then that must be paid to the liquidator as part of the assets. …"

9. The parties were in agreement that if Lonsdale had not had a cross-claim qualifying for insolvency set-off, the dispute referred by Bresco would have been within the adjudicator's jurisdiction, even though Bresco was by then in liquidation and the contract had ended.

10. The main cornerstone of Lonsdale's argument on jurisdiction was that the net claim was a dispute under the insolvency regime and no longer a dispute under the contract.

11. Lord Briggs was clear that he did not consider construction adjudication *"in any way incompatible"* with the insolvency regime. He rejected the notion that the dispute under the construction contract and any cross-claim ceased to exist such that they were immediately replaced by an insolvency claim. He held that such claims could not *"simply melt away so as to render them incapable of adjudication"*.

12. The law of insolvency set-off does not compel the liquidator *"to bring all disputes about the claims and cross-claims qualifying for set-off for resolution in a single proceeding"*. Instead, it was perfectly appropriate to *"untangle a complex web of disputed issues arising from mutual dealings between the company and a third party"*, including by adjudication. As a matter of insolvency law *Stein v Blake [1996] AC 243* was not authority for the proposition that cross-claims which fall within insolvency set-off cease to

exist for all purposes after the commencement of the insolvency. Lord Hoffman said in *Stein*:

> *"The cross-claims must obviously be considered separately for the purpose of ascertaining the balance. For that purpose they are treated as if they continued to exist."*

13. Accordingly, a party could still retain its rights as to dispute resolution, including adjudication.

14. In short, there was no incompatibility; if the mere existence of a cross claim (even if undisputed and however small) were to deprive a company of its right to adjudicate this would be "*a triumph of technicality over substance*".

The futility argument

15. The argument was this: even if there is jurisdiction, an adjudication in the context of insolvency set-off will not ordinarily lead to an enforceable award such there will be an exercise in futility that the court can and ordinarily should restrain by injunction.

16. Lord Briggs described the adjudication process as:

    c. Semi-compulsory;

    d. Not subject to exclusions of particular types of persons;

    e. Wide in jurisdictional terms;

    f. Speedy (given the strict time limits);

    g. Often cheaper than litigation and arbitration;

    h. Reliant on independent and often expert adjudicators, giving veracity to the process; and

    i. Whilst less reliable than litigation and arbitration, it was still subject to *de novo* determination.

17. Lord Briggs considered the fact that Bresco was in liquidation was not a sufficient reason to restrain the adjudication proceedings by way of an injunction. He said that the scheme introduced by the 1996 Act was "*conspicuously successful addition to the range of dispute resolution mechanisms available for use in what used to be an over-adversarial, litigious environment*" and went on to say that:

> "*...it is simply wrong to suggest that the only purpose of construction adjudication is to enable a party to obtain summary enforcement of a right to interim payment for the protection of its cash flow, although that is one important purpose. In the context of construction disputes adjudication has, as was always intended, become a mainstream method of ADR, leading to the speedy, cost effective and final resolution of most of the many disputes that are referred to adjudication. Dispute resolution is therefore an end in its own right...*"

18. In respect of injunctive relief, Lord Briggs said that the court may "*restrain a threatened breach of contract but not, save very exceptionally, an attempt to enforce a contractual right, still less a statutory right [e.g. right to adjudicate]*". He considered that Lonsdale had failed to overcome what he described as "*that very steep hurdle*".

19. Lord Briggs went on to say that:

> "*The proper answer to all these issues about enforcement is that they can be dealt with, as Chadwick LJ suggested, at the enforcement stage, if there is one. In many cases the liquidator will not seek to enforce the adjudicator's decision summarily. In others the liquidator may offer appropriate undertakings, such as to ring-fence any enforcement proceeds: see the discussion of undertakings in the Meadowside case. Where there remains a real risk that the summary enforcement of an adjudication decision will deprive the respondent of its right to have recourse to the company's claim as security (pro tanto) for its cross-claim, then the court will be astute to refuse summary judgment.*"

20. Lord Briggs also considered the potential burden on the TCC in dealing with such claims; it is a cost-neutral mechanism created by statute and simply because costs will be incurred in this does not mean that an injunction preventing the exercise of a statutory right to adjudication is justified. He thought that the TCC could deal with the burdens.

21. In the round, the Supreme Court allowed the appeal so that the adjudication could proceed.

Where are we now?

Finality in practice?

22. Lord Briggs referred to a "*chorus of observations, from experienced TCC judges and textbook writers to the effect that adjudication does, in most cases, achieve a resolution of the underlying dispute which becomes final because it is not thereafter challenged.*"

23. The Supreme Court thought that adjudication was not just a temporarily binding form of ADR helping to solve the cash flow problem in the construction industry and that should not be regarded as the sole objective of adjudication, but he did accept that "*when compared with arbitration and litigation, [adjudication's] speed and economy come at an inevitable price in terms of reliability*".

24. In essence, many of the disputes ought to be resolved by adjudication and without the need to involve the courts.

The role of an insolvency practitioner

25. The Court of Appeal decision was seen as a noose around the neck of insolvency practitioners, being left to determine disputes themselves[7](with or without potentially first obtaining expensive advice).The decision has been heralded by a number of commentators as a welcome decision for insolvency professionals, who will now look to utilise adjudication as a quick and convenient route to determine claims in the liquidation of construction companies.

[7]With a heavy risk that a disgruntled party would make an application to challenge that decision, with a real risk of an insolvency practitioner being criticised when the detail of such disputes is not ordinarily within their expertise (which the Supreme Court accepted).

The (expanded?) role of the adjudicator

26. It is well-established that an adjudicator has jurisdiction to determine every point which may be advanced by the responding party; however, it is commonplace for adjudicators to refuse to deal with defences well outside the scope of the dispute referred to him/her (which may happen more often in insolvency because of the rules on set-off). Lord Briggs said:

> *"It is true that the effect of insolvency set-off may mean that cross-claims raise issues wholly out with the purview of one or more construction contracts, such as the apportionment of liability for personal injuries, or liability under mutual dealings between the same parties in some other commercial field. In such a case the adjudicator will need to have regard to them, if they amount to a defence to the disputed construction claim being referred, but may have simply to make a declaration as to the value of the claim, leaving the unrelated cross-claim to be resolved by some other means. That is a remedy well within the adjudicator's powers. Nonetheless the adjudicator's resolution of the construction dispute referred by the liquidator may be of real utility to the conduct of the process of set-off within the insolvency process as a whole."*

27. The role of an adjudicator may well have expanded a little, but it should not become unwieldly.

The role of the TCC

28. The role of the TCC will again be more focussed on whether to grant summary judgment and/or a stay on enforcement, with greater emphasis on appropriate undertakings/security where there are insolvent companies and cross-claims: see *Meadownside v 12-18 Hill Street* [2019] EWHC 2651 (TCC).

M DAVENPORT BUILDERS LTD V GREER [2019] EWHC 318 (TCC)

29. In ***Davenport***, the court reminded the construction industry that in any case where there is a perceived risk of insolvency the employer should be

scrupulous to protect itself by serving timeous Payment Notices or Pay Less Notices.

THE CONSTRUCTION INDUSTRY GENERALLY

30. Many industries have been hit hard by Brexit and COVID-19, including the construction industry. The quicker, cheaper and more-efficient way to determine such disputes has now been re-engaged; no doubt the industry welcomes this.

Amit Gupta
Enterprise Chambers
T: 020 7405 9471
E: amitgupta@enterprisechambers.com