BANKING AND FINANCIAL SERVICES UPDATE – THE GOOD, THE BAD AND THE UGLY

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Introduction

1. As Lucy Walker is returning from a trip to the desert, in the American Southwest, to make this presentation, it seemed fitting to find a Western themed title for this talk. There are three topics:

   Part 1: First, looking at the current advisory protection available to consumers and investors, and the FCA proposals for a new duty of care concept, which may go some way to fashioning a new duty to advise in the financial services context. Lucy will consider whether this is for "the good".

   Part 2: Second, Hugh will consider the extent to which networks of independent financial advisers ("IFAs") are liable for the activities of their appointed representatives ("ARs"), including in particular a consideration of where we are left following the decision of the Court of Appeal in *Anderson & Others v Sense Network Limited* [2019] EWCA Civ 1395 and whether this is "bad".

   Part 3: Thirdly, Hugh will consider the decisions at first instance, and in the Court of Appeal, in *Singularis Holdings Ltd v Daiwa Capital Markets Europe Limited*, which arise in the context of an application of the *Quincecare* duty, and consider how the Supreme Court might tidy up the law in relation to attribution and the so called "one man company" concept, one of the "ugly" areas of the law as things currently stand.

Part 1: Bank and lender liability: moving towards a general duty to advise?

2. Bank and lender liability tends to be heavily dominated, as would be expected, by the contractual frameworks within which the services or investment product are provided[1]. Typically, there is no duty of care to advise. The common law provides some limited additional protection, though facts outside the ordinary will normally be required before it does so[2]. This may arise as a matter of some special contract, or by reason of the voluntary conduct of the bank prior to or during the contract. It may be contended that these facts give rise to a "special relationship"[3]. See in particular Lord Scarman in *Morgan* at [709C]: "*When, however, a bank, as in the present case,*

[1] Ordinarily this will seek to exclude or limit any general or specific advisory duty; see *JP Morgan Chase Bank v. Springwell Navigation Corp* [2008] EWHC 1186 (Comm). Though note that this will be ineffective to remove the statutory protection available in relation to misrepresentations; see more recently *First Tower Trustees Ltd v CDS Superstores (International) Ltd* [2018] EWCA Civ 1396, [2019] 1 WLR 637.

[2] See discussion of when a common law duty of care will arise in *Paget's Law of Banking,* 15th Edition at 4.26, where it is suggested this may be limited to where a bank agrees to provide advice misrepresents a product or service, or provides a reference. See also

[3] This was recognised in *National Westminster Bank plc v Morgan* [1985] 1 AC 686 at 709C, as explained by Sir Eric Sachs in *Lloyds Bank plc v Bundy* [1975] QB 326.

goes further and advises on more general matters germane to the wisdom of the transaction, that indicates that it may - not necessarily must - be crossing the line into the area of confidentiality so that the court may then have to examine all the facts including, of course, the history leading up to the transaction, to ascertain whether or not that line has, as here, been crossed. It would indeed be rather odd if a bank which vis-à-vis a customer attained a special relationship in some ways akin to that of a 'man of affairs' - something which can be a matter of pride and enhance its local reputation - should not, where a conflict of interest has arisen as between itself and the person advised, be under the resulting duty now under discussion. Once, as was inevitably conceded, it is possible for a bank to be under that duty, it is, as in the present case, simply a question for 'meticulous examination' of the particular facts to see whether that duty has arisen." But the level of protection this provides to the consumer, or investor, is limited, and requires, as we have already noted above, special facts.

3. Some regulatory protection also exists, in connection with advice and services provided in relation to 'specified investments' and 'specified activities' for the purposes of the Financial Services & Markets Act 2000 ("FSMA"), (Regulated Activities) Order 2001 ("RAO"). This regime imposes mandatory rules relating to advising and selling standards, information requirements and the post contractual administration and enforcement of certain products. The FCA Handbook sets out conduct standards and a private person who has suffered loss as a result of a rule breach contained in the FCA Handbook has a right of action in damages against the regulated provider, (now s.138D FSMA, formerly s. 150). The extent to which this provides effective investor protection to those who receive advice from ARs will be considered in Part 2. Typically, in any event, it will not provide protection for or in relation to secured lending contracts (as opposed to a product, such a hedging product, sold alongside it). Nor, as the law currently stands, will a limited company have a right of action for breach of the conduct of business rules[4].

4. There are now FCA proposals for a new duty of care concept. In 2018 the FCA issued a discussion paper and in 2019 has invited views on the imposition of a new 'duty of care' to be owed by regulated firms to consumers, with the aim of reducing consumer harm and preventing conflicts of interest. This may herald a move towards a general duty to advise.

5. The above notes are intended to provide the reader with an initial taste of this first part of the talk. All these matters are addressed by Lucy in the first set of slides accompanying these notes, and will be considered in further detail by her in her section of the talk.

[4] As to which see the first instance decisions of David Steel J in the *Titan Steel Wheels* case [2010] EWHC 211 and Flaux J in the *Camerata Property* case [2012] EWHC 7 and HHJ Keyser QC in the *MTR Bailey & Anr v Barclays Bank PLC*, albeit in the latter case the Court of Appeal gave permission on the point (see [2015] EWCA Civ 667), though the case was settled before the hearing of the appeal)

<u>Part 2: Section 39 FSMA and responsibility for appointed representatives following the decision of the Court of Appeal in *Anderson v Sense*</u> [5]

Introduction

6. The issue is the extent of liability of financial advisory networks, and other financial institutions, who as principals, engage ARs to provide financial advice and services to members of the public, and whether they should be liable, beyond the terms of their contract with the AR, for losses consequential on non-compliant and negligent financial advice and services given by those IFA agents. The decision of the Court of Appeal in *Anderson & Others v Sense Network Limited* [2019] EWCA Civ 1395 was that, on the facts of that case, they should not, upholding the decision at first instance (of Jacobs J) to the same effect[6]. The main issue arising was the effect of the statutory "deeming" responsibility, under s 39(3) of the Financial Services and Markets Act 2000 ("FSMA") (and before it, s 44, of the Financial Services Act 1986 ("the 1986 Act"). This, in certain circumstances, renders the principal liable for the advice and conduct of the AR as if the principal had expressly permitted it. The secondary issue was whether liability should be fixed on the network under the common law principle of vicarious liability[7]. We consider below whether the outcome of the Court of Appeal decision is unsatisfactory or "bad".

The facts in Anderson & Others v Sense Network Limited

7. The claimants in *Anderson v Sense* were ninety-five individuals ("the investors") who paid substantial sums into a collective investment scheme ("CIS" and "the scheme", where appropriate) recommended to them by IFAs named Midas Financial Solutions Ltd in Aberdeen ("Midas"). In fact the scheme was a "Ponzi" scheme operated by Alistair Greig, the MD of Midas ("Mr Greig"). The true nature of the scheme was eventually exposed by a whistle-blowing notice in August 2014 leading to enforcement action against Midas and Mr Greig by FCA in September 2014. That investigation revealed that some 279 members of the public had contributed some £12.8 million to the scheme but that only funds of £379,000 remained. All the investors believed the scheme to be a legitimate financial product marketed and sold – alongside life insurance, investments, pensions and mortgages – by Midas, which was an agent and an AR of the Respondent, Sense Network Ltd ("Sense") under s 39 of FSMA.

8. The relationship between Sense and Midas was governed by: (a) s 39 of FSMA (together with delegated legislation and statutory rules made thereunder) which creates a statutory agency of principal (directly regulated) firm and AR (indirectly regulated) firm; and (b) the Appointed

[5] These notes draw on work done by Hugh Sims QC, Gerard McMeel and Jay Jagasia when acting on behalf of the claimants in the Court of Appeal and in seeking permission to the Supreme Court in *Anderson v Sense.*
[6] See [2018] EWHC 2834 (Comm), [2019] Bus LR 1601.
[7] This was an issue which the Supreme Court was due to consider on 13 and 14 February 2019 in *Frederick v Positive Solutions (Financial Services) Ltd* (UKSC 2018/0067), on appeal from [2018] EWCA Civ 431, but which appeal was compromised before it could be heard.

Representative Agreements signed in 2007 and 2013 and which were in materially identical terms ("the AR Agreement"). The latter is the contract expressly required by s 39(1) under which the principal must accept responsibility for the AR in writing.

9. Section 39(3) of FSMA states quite simply: "The principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility."

10. The investors were not party or privy to the AR Agreement, and were in all likelihood unaware of its existence. Their legal advisers first had sight of it when the 2013 version was disclosed in the pre-action process. The principal terms of the AR Agreement dated 7 February 2013 between Sense and Midas need not be considered in detail here[8]. The important point to understand for the purposes of this talk is that it provided that Midas was only authorised to arrange or advise in relation to investments for which there was a "Company Agency", which meant an agency which Sense had with the provider institution.

11. The advice by Midas advisers to contribute to the scheme was a breach by Midas of its obligations to Sense under the AR Agreement, but this was not known by the investors. The existence of the scheme and Midas's activities in relation to it were also unknown to Sense prior to the whistle-blowing notice in August 2014. The letters acknowledging contributions to the scheme sent to the investors were on Midas headed stationery with the mandatory statutory footer making status disclosure (as did Midas's representatives' business cards): "*Midas Financial Services (Scotland) Ltd. is an appointed representative of Sense Network Limited, which is authorised and regulated by the Financial Services Authority*." That statement identified (a) Midas as the agent or financial intermediary; (b) Sense as the principal and directly authorised FSA firm; and (c) the FSA (and in later instances the FCA) as the financial regulator.

The Statutory Framework in more detail[9]

12. The legal and regulatory environment in which financial advisers, intermediaries and "networks" such as Sense operate is detailed and prescriptive. The financial services industry has been governed by the (various iterations of) rules contained in, or made under, FSMA since 1 December 2001. Prior to the commencement of FSMA in December 2001, from 29 April 1988 investment firms were regulated under the 1986 Act. Separate legislation made provision for banks and insurers. Much of FSMA builds on the foundation of the 1986 Act, but applied its approach to all three financial sectors.

[8] They were recorded in more detail at paras [28 to 37, and 41 to 42] of the first instance judgment handed down on 26 October 2018: [2018] EWHC 2834 (Comm), [2019] Bus LR 1601.

[9] For a helpful overview of the regime governing networks and other principals see the judgment of the Upper Chamber in *Palmer v Financial Conduct Authority* [2017] UKUT 313 (TCC)[9], paras [10-38], and see [62-86].

13. From 1 December 2001 to 1 April 2013 there was a single regulator: the FSA. On 1 April 2013 the FSA became the FCA under amendments to FSMA. The applicable regulator promulgated general principles and made detailed rules pursuant to powers conferred by FSMA in its *Handbook*.

14. The FSA/FCA has statutory powers to fine and discipline *authorised* persons for breaches of its principles and rules (FSMA ss 205 and 206), but not their ARs.

15. Breach of regulatory rules in the FSA/FCA Handbook, including those in the Conduct of Business Sourcebook ("COBS"), is generally made actionable against an authorised person as a breach of statutory duty by any private person who suffers loss as a result: s 150 of FSMA. This has been superseded with effect from 1 April 2013 by s 138D(2) in relation to FCA rules, as supplemented by the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001, SI 2001/2256 ("Rights of Action Regulations"), regulation 3(1)(a), to include in general any individual. All the lead claimants in this case fell within the Rights of Action Regulations.

16. Every authorised person (or firm) has one or more permissions – in its Part IV (and subsequently renamed Part 4A) of FSMA permission or FSA/FCA licence – to conduct different species of investment or financial activity.

17. The Part IV/Part 4A permissions proceed by reference to the "regulated activities" in respect of "specified investments" identified by the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) as amended ("RAO"), made under s 22 of FSMA.

18. Breach of the general prohibition is a criminal offence under s 23 of FSMA. An authorised person (such as Sense) cannot act in breach of the general prohibition in s 19 of FSMA – that is, be guilty of conducting unauthorised business, but it is nevertheless required to observe the parameters of its permission under s 20. In contrast an exempt person, including an AR under s 39 of FSMA, may breach the general prohibition if it acts outside of the activities for which it is exempt under s 39(1), and incur criminal liability.

19. The 1986 Act introduced the statutory concept of the AR, which allowed regulated persons to appoint other persons for whom they accepted regulatory responsibility, and as a measure of consumer protection initiated a regime of vicarious responsibility, whereby the appointing principal was deemed responsible for everything said or done, or not said or done, by its ARs. That concept was extended to the whole financial services industry by s 39 of FSMA.

20. Regulated activities under FSMA/the RAO include arranging investments (RAO art 25) and investment advice (RAO art 53). A security (defined in RAO art 3, by reference to RAO arts 76 to 82) includes, by reason of RAO art 81, units within a CIS (under part XVII of FSMA).

21. Any person who wishes to carry on any regulated activity under FSMA/RAO must be either an authorised person or an exempt person in respect of that activity: s 19 of FSMA.

22. Sense itself was authorised by the FSA on 1 May 2007. Midas was an AR in Sense's network from 27 September 2007. Sense's Part IV (subsequently Part 4A) permission embraced the regulated activities of: (a) advising on investments; (b) arranging (bringing about) deals in investments; (c) making arrangements with a view to transactions in investments; and (d) agreeing to carry on a regulated activity.

23. As stated the relationship between Sense and Midas is governed by s 39 of FSMA (together with delegated legislation and statutory rules made thereunder). This also governs the responsibility of Sense to its regulator for the conduct of its ARs (s 39(4)) and its potential civil liability to persons dealing with its ARs (s 39(3)).

24. Section 39 of FSMA has an important legislative history. Its predecessor (s 44 of the 1986 Act) was aimed at making financial institutions, such as life insurers, fully responsible for the self-employed individual salespersons traditionally engaged by life insurers and other firms, to the same extent as if they were employees. However, s 39 and its predecessor was also used by "network" firms such as Sense.

25. FSMA and the rules made thereunder have three principal consequences. First, as between Sense (as principal) and Midas (as AR) Sense stands in the shoes of the FSA/FCA, and is responsible for the supervision of Midas, and its compliance with the regulatory regime. Secondly, whilst in company law terms Midas is an independent business, under FSMA the employees of Midas are for regulatory purposes deemed to be the responsibility of Sense. Thirdly, again so far as the rules are concerned, the clients of Midas are effectively the clients of Sense.

26. For a network its ARs are an integral part of its business, and it would have no revenue without them. The quid pro quo is that they are responsible under the statute for everything said or done by the AR in the course of carrying on investment business.

27. The parts of s 39 central to the reasoning of the Court of Appeal and the judge at first instance states as follows:

> *(1) If a person (other than an authorised person)—*
>
> *(a) is a party to a contract with an authorised person ("his principal") which—*
>
> *(i) permits or requires him to carry on business of a prescribed description, and*
>
> *(ii) complies with such requirements as may be prescribed, and*
>
> *(b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing,*
>
> *he is exempt from the general prohibition in relation to any regulated activity comprised in the carrying on of that business for which his principal has accepted responsibility.*
>
> *(1A) This subsection applies to a person —*
>
> *(a) if his principal is an investment firm or a credit institution, and*
>
> *(b) so far as the business for which his principal has accepted responsibility is investment services business,*

unless he is entered on the applicable register.

(1B) The "applicable register" is—

> *(a) …[not relevant]*
>
> *(b) …*
>
> *(c) in any other case, the record maintained by the Authority by virtue of section 347(1)(ha).*

[…]
(2) In this Act "appointed representative" means—

> *(a) a person who is exempt as a result of subs (1), or*
> *(b) ….*

(3) The principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility.

(4) In determining whether an authorised person has complied with—

> *(a) a provision contained in or made under this Act, or*
>
> *(b) a qualifying EU provision that is specified, or of a description specified, for the purposes of this subsection by the Treasury by order,*

anything which a relevant person has done or omitted as respects business for which the authorised person has accepted responsibility is to be treated as having been done or omitted by the authorised person.

(5) "Relevant person" means a person who at the material time is or was an appointed representative by virtue of being a party to a contract with the authorised person.

(6) Nothing in subsection (4) is to cause the knowledge or intentions of an appointed representative to be attributed to his principal for the purpose of determining whether the principal has committed an offence, unless in all the circumstances it is reasonable for them to be attributed to him.

28. In summary (a) s 39(1) is the licensing provision establishing and delimiting the AR's exemption from the general prohibition in s 19; (b) s 39(3) determines the civil liability of the principal to third persons dealing with its ARs; (c) s 39(4) determines the statutory responsibility of the principal, such as by way of fines or censure (under ss 205 and 206 of FSMA); and (d) s 39(6) modifies s 39(4) so that the principal does not thereby become criminally responsible for its ARs' conduct unless the circumstances make it reasonable to attribute the ARs' conduct to it.

29. The details are fleshed out by secondary legislation: the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001, SI 2001/1217 (as amended) ("the AR Regulations"). There are therefore two further requirements for the contract in writing.

30. First, the contract must permit or require the representative to carry on business of a prescribed description: FSMA 2000, s 39(1)(a)(i). Under the AR Regulations this business is defined by reference to the generic categories of the RAO and includes: arranging deals in securities and contractually-based investments; advising on investments; and agreeing to carry on any of the aforementioned activities: AR Regulations, reg 2, which describes the regulated activities for which ARs may be exempt by reference to articles in the RAO, including arts 25 and 53.

31. Secondly, the contract must comply with prescribed requirements, again by reference to RAO generic categories: FSMA 2000, s 39(1)(a)(ii). See the AR Regulations, reg 3; and see the definitions in reg 1.

The reasoning of the Court of Appeal - introduction

32. There were three issues before the Court of Appeal (Judgment of Lord Justice David Richards, [22]): First, was Sense liable to the investors for the conduct of Midas under s 39(3) of FSMA? Secondly, was Sense vicariously liable for the tortious conduct of Midas at common law? Thirdly, was the Judge correct to characterise the scheme as a CIS within the meaning of s 235 of FSMA. A single substantive judgment was delivered by Lord Justice David Richards, in which Lord Justice Hamblen and Mr Justice Snowden concurred.

The Court of Appeal – section 39

33. In respect of the first issue it was accepted that it was at least negligent of Midas's advisers to recommend a scheme which was not authorised (at [24]). Furthermore, the advisers at Midas had arranged or advised for the investors to participate in the scheme, which formed the basis of the claim, and that should be separated from the operation of the scheme by Mr Greig. If Sense had accepted responsibility for all investment advice by Midas the fact that the scheme was operated by Mr Greig or Midas (which involved dishonesty and illegal conduct) would not take it outside the activities for which Sense had accepted responsibility (at [25]).

34. Lord Justice David Richards started with the language of s 39. He concluded that section 39(3) must be read as referring back to s 39(1) and the words "business of a prescribed description", which must be a reference to the species of business described in generic terms in the AR Regulations (at [31]). Crucially, he noted that: "*In order to determine the extent of the acceptance of responsibility it will be necessary to refer to the terms of the document by which the authorised person accepts responsibility*." (at [32]). Thus his focus was on the linguistics of section 39(1) (from [30] to [35]) and not s 39(3) because on Lord Justice David Richards's view s 39(1) "*defines the scope of section 39(3)": "Exemption [of the AR] and liability [of the principal] are co-extensive*." (at [35]).

35. Lord Justice David Richards rejected a submission that s 39(3) extended to all those activities for which the principal was itself authorised (at [37]). He also rejected a submission that the words "*or part of*" permitted the principal, as a matter of contract, to delegate part of its own statutory licence to an AR and thereby delegate one or more category of business for which the principal was itself authorised, but that that would only be relevant to the internal relationship of principal and AR and have no impact on liability under s. 39(3) (at [38]).

36. In respect of the words “as if” in s 39(3) Lord Justice David Richards stated: “*in short, they recognise that at common law giving authority for an activity will not necessarily impose liability on the principal for all actionable acts or omissions of the agent that may occur in relation to the conduct of that activity, particularly as regards tortious liability. These words overcome those difficulties*.” (at [39]).

37. Lord Justice David Richards rejected a submission that his approach made it impossible to distinguish between "what" and "how", whilst accepting that a principal could not restrict liability by reference to failure by the AR to properly conduct business for which responsibility had been accepted. He concluded: “*it will be a rare case which presents any difficulty in distinguishing between what activity may be carried on and how a permitted activity is carried on*” (at [40]).

38. Lord Justice David Richards rejected the investors’ reliance on Professor Gower’s seminal report – LCB Gower, *Review of Investor Protection, Part I*, Cmnd 9125 (1984) – which lay behind s 44 of the 1986 Act, the predecessor to s 39. He regarded it as useful for identifying the general purpose of those parts of s 44 carried over into s 39, but impermissible for the detailed construction of s 39 (at [50-53]). However he did rely on the Gower Report to further elucidate his understanding of “*as if”:* “*The deeming words of section 39(3) ("to the same extent as if he had expressly permitted it") overcome the difficulties identified by Professor Gower of the circumstances, particularly in the case of tortious liability, when a principal will or may not be liable for the acts or omissions of an agent. I would add these words may also be necessary because the wide drafting of section 39(3) could see the appointment of ARs whose agency role is either very limited or perhaps non-existent*.” (at [54]).

39. Lord Justice David Richards rejected a submission that changes to FSMA to implement the Markets in Financial Instruments Directive 2004/39/EC (“MiFID 1”), by the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007 (SI 2007/126) should either be used to construe s 39 or be taken to have changed its construction (at [41-46]).

40. Turning to the detailed terms of the AR Agreement Lord Justice David Richards relied on the concept of a “Company Agency” to limit the liability accepted, because these restrictions had been communicated to Midas and its other ARs (although not of course the investors) (at [55-57]).

41. Therefore the Court of Appeal reached the conclusion that the contractual construction of the AR Agreement document, and other documents incorporated by reference in it, to which the investors were not privy (and might not have sight of until disclosure during the course of proceedings) controls the extent of civil liability between the principal and third parties imposed by a public statute.

Court of Appeal - Vicarious Liability

42. Lord Justice David Richards dealt briskly with this ground saying there was no substance in the appeal on this ground because the Judge had found that Midas was carrying on its own independent business (at [61-64]). He, therefore, did not go on to deal with the question as to whether principles of vicarious liability were applicable to economic torts committed by commercial agents, as left open by the Court of Appeal in *Frederick* [2018] EWCA Civ 431 (at [65])[10].

Court of Appeal - CIS

43. The Court of Appeal agreed with the first instant judge's conclusion that the scheme was a CIS and did not fall within any applicable exemption (at [66-82]).

The outcome – unsatisfactory?

44. The outcome in this case is to be contrasted with that where an investor is provided with advice by an employee of a directly regulated firm, who does not operate through a network arrangement. In those circumstances the firm is likely to be liable, even if the employee provides unauthorised advice. It serves to endorse, or create, a two-tier system of investor protection in the UK such that investors dealing with the representatives, or employees, of directly authorised firms under FSMA have statutory protection against fraud and mis-selling and a claim against the FSMA authorised person, whereas investors dealing with the representatives, or employees, of ARs under FSMA have no such protection, and no such rights against a FSMA authorised person.

45. So at a high, policy, level the law is left in a bad state, as customers or investors will be left in a different position depending on who they received advice from: an IFA who is an employee of a regulated firm receiving greater protection than if they had received advice from an IFA acting for an AR who is subject to a tight AR agreement with its principal. It may be said this requires legislative action, but there are also good reasons as to why it may be considered the decision of the Court of Appeal is itself wrong.

Section 39 – technical criticism

46. The Court adopted a primarily linguistic and textual approach to statutory construction. A purposive approach, giving due weight to the history, context and purposes of s 39 of FSMA, would have resulted in a different outcome. It is questioned whether this is part of a wider trend towards statutory construction, and something of a backwash from the more literal approach taken to contracts by some of the judiciary following cases like *Arnold v Britton*. It reflects a

[10] This also formed the basis of the appeal to the Supreme Court in that case, later compromised.

freedom of contract approach which leaves little work for the statute. In this respect it may be said the Court failed to follow the purposive approach to the construction of s 39 (and its predecessor) in a stream of authority from *Martin v Britannia Life Ltd*.[11], through *Page v Champion Financial Management Ltd*[12], *Ovcharenko v InvestUK Ltd*[13], *Palmer v Financial Conduct Authority*[14], to *R v Financial Ombudsman (on the application of Tenetconnect Services Ltd)*[15].

47. The consequence of the linguistic approach adopted is, as discussed above, to frustrate, substantially if not entirely, the public policy behind the statutory provisions which was clearly identified in the legislative history of the provisions, including the Gower Report and the HM Government White Paper (Department of Trade and Industry, *Financial Services in the United Kingdom – A New Framework for Investor Protection*, Cmnd 9432 (1985)). Gower recommended that "*it should be specifically enacted that the company to which they [the salespersons] are tied is fully responsible for their acts to the same extent as if they were its employees with full authority to act on its behalf*." (Gower, *Review of Investor Protection. Part I*, para 8.50.). The policy behind s 44 was addressed by the Minister, Lord Cameron (H.L. Vol 480, cols 991-992, when addressing certain amendments to what was then Clause 44 (bold emphasis added below)): "*Accordingly Clause 44 provides they do not need separate authorisation. But it provides also that their authorised principal…is responsible for their actions, and if the representative offends against any of the rules laid down under the Bill it will be the same as if the authorised person had himself broken the rules. Your Lordships will recognise that underlying this is the intention to ensure that in all respects that matter to this Bill appointed representatives are treated effectively as if they were employees of their authorised principal and not independent businesses*."

48. The principal legislative purpose behind section 44 (now s39(3)) was therefore to ensure liability for an AR was the same as if they were an employee. The Court of Appeal's approach was to pick out a lesser statutory purpose but ignore the principal one, as referred to above.

49. It may also be said that the approach taken by the Courts fails to give effect to the high level of investor protection intended by MiFID 1, since, if the Court's conclusions are correct, an investor is not able to ascertain the scope of authorised activities from the public register when they are dealing with an AR, contrary to art 5.3.

Section 39 – some takeaway points

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[11] [2000] Lloyd's Rep PN 412.
[12] [2014] EWHC 1778 (QB). https://www.bailii.org/ew/cases/EWHC/QB/2014/1778.html
[13] [2017] EWHC 2114 (QB).
[14] [2017] UKUT 313 (UT), [2017] All ER (D) 57 (Aug).
https://www.bailii.org/uk/cases/UKUT/TCC/2017/313.html
[15] [2018] EWHC 459 (Admin), [2018] 1 BCLC 726.

50. Following the decision of the Court of Appeal, the primary consideration is the contract: contract is king, and advice as to the likely success of any claim against a network firm will depend on the terms of the AR Agreement, which will need to be obtained as part of any pre-action disclosure.

51. It may also be said that investors or customers should be advised, where possible, to consider requesting a copy of that AR Agreement before they enter into any significant arrangements with an AR before deciding whether to proceed with investment with them. The mere fact that they are an AR and registered on the principal's online register with the FCA will be insufficient.

52. Finally, savvy investors may well decide to shun AR firms in favour of an arrangement, direct, with a regulated firm. Ironically this serves to undermine the network model on which networks, such as Sense, are built. This may also be considered to be a "bad" outcome from the point of view of investors overall if it has any substantial effect on investor behavior.

Vicarious liability - discussion

53. The Court of appeal purported to dispose of the vicarious liability issue on the basis of the judge's findings of fact as to the business of Midas being an "independent business". It may also be said that this could be attacked on technical grounds, aside from the policy factors referred to above:

54. The Supreme Court in *Cox* stated that the essential two factors are that ([30]):

> *"…The individual for whose conduct it may be vicariously liable must carry on activities assigned to him by the defendant as an integral part of its operation and for its benefit. The defendant must, by assigning those activities to him, have created a risk of his committing the tort."*

55. It is at least arguable that the Court of Appeal failed properly to apply recent authoritative guidance of the Supreme Court as to the applicable principles[16], and in particular should have held that the torts had been committed as a result of activity undertaken by the tortfeasors on behalf of Sense. The activity of financial advice was integral to Sense's business, and in this respect the businesses of Sense and Midas were interdependent and interconnected. Sense, by engaging Midas and its advisers, created the risk of the torts being committed. In these circumstances it is well arguable that the Court should have held that Sense was vicariously liable for the negligent advice of Midas.

56. In reality many larger networks use single branding, analogous to the franchising model used by well-known fast food chains. Here the brochures, stationery and business cards of Midas had to

[16] *Cox v Ministry of Justice* [2016] UKSC 10, [2016] AC 660; *Mohamud v Wm Morrison Supermarkets plc* [2016] UKSC 11, [2016] AC 677.

be approved by Sense, and were required to make clear that Midas was part of the umbrella organisation of the network. The promotional materials all contained the mandatory statutory disclosure making reference to both to Sense as principal and the FSA/FCA as regulator. Any lawyer advising an investor as to his rights would immediately pinpoint Sense as an appropriate defendant. The training, supervision and overall compliance function resides in the principal. These facts may be said to have cried out for the application of the *Cox* principles.

57. As for the judge's findings at first instance (which the Court of Appeal simply recited) based on the application of the *Cox* principles, given the highly integrated nature of financial advisory networks his conclusion that individual member firms are "recognisably independent businesses" is, putting at its lowest, questionable. There was clearly a high degree of inter-dependence. But in any event simply because there exist independent businesses does not mean there is no scope for the principles of vicarious liability to apply. The test and focus is whether the activities under consideration, in general terms, were assigned as an integral part of the principal's operation and for its benefit. The fact that those activities, having thus been assigned, can also be seen to be a business of the assigned person, the agent, does not remove it from the *Cox* principles. The Court of Appeal's approach, upholding the Judge, involved at least an arguable misapplication of those principles. It ought to have been irrelevant that the AR in this case gave advice which exceeded the bounds of its authority and defied express instructions[17].

58. That said, the case raises a larger question, which the Court of Appeal did not grapple with, which is whether the *Cox* principles should apply to economic loss cases where the tort relied on is a reliance based tort committed by an agent (not an employee).

Liability by networks for their ARs – overall conclusions

59. If the law remains as stated by the Court of Appeal a well structured network firm should be able to insulate itself from unauthorized activities of its ARs, save to the limited extent that if the area of activity and product is authorized then if the advice given is negligent or in breach of duty then liability will be imposed under section 39(3). The Court has not recognised that section 39(3) has a role to play going beyond this. The investor may also struggle to establish liability on the basis of common law vicarious liability principles, and it must remain open to debate whether the principles as more recently developed by the Supreme Court in *Cox* should be applied to cases involving economic loss consequent on reliance based torts. If all else fails, the investor may have some limited protection under the FSCS where the activity in question is a regulated one.

Part 3: *Singularis* in the Supreme Court – the issue in *Singularis* and the Quincecare Duty[18]

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[17] cf. the decision in *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366, at [22]

[18] This section of the notes draw on: (i) materials prepared for the Banking Litigation Update seminar held at the Commercial Team seminar in 2018, prepared by Holly Doyle, Hugh Sims QC and Lucy

Introduction

60. In July of this year there was a constitutional first: the Supreme Court sat in Cardiff for a week. One of the cases they heard was the appeal from the decision of the Court of Appeal in *Singularis Holdings v Daiwa Capital Markets Europe* [2018] EWCA Civ 84. Some of the cases heard had a connection with Wales, but this case had no obvious connection. It has wide significance, however, for the law of England and Wales, particularly on the question of the law of attribution in company disputes. The appeal concerns whether the dishonest state of mind of the sole shareholder and a director of a company is attributable to the company for the purposes of a claim in negligence against a third party bank or broker and, if so, what the consequences are of that attribution.

61. Over a quarter of a century ago it was established in *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363 that a bank will be liable to its customer for damages in negligence if it makes a payment in circumstances where it had reasonable grounds for believing that the instruction to make the payment was an attempt to misappropriate the funds of its customer (commonly known as the "*Quincecare* duty"). This statement of principle was approved by the Court of Appeal in *Lipkin v Gorman.*

62. That duty was found to be applicable by the first instance judge in *Singularis,* Rose J as she then was. The Court of Appeal upheld that decision. The Supreme Court judgment is now awaited. There may be some consideration of the ambit of the *Quincecare* duty in the decision of the Supreme Court, but it is likely to be mainly concerned with questions of the law of attribution, and in particular the test for the so called "one man company", a running sore since the decision of the House of Lords in *Stone & Rolls Ltd (in liquidation) v Moore Stephens (a firm)* [2009] UKHL 39*.*

The facts in Singularis

63. Mr Al Sanea was a director and sole shareholder of Singularis Holdings Ltd ("SHL") and in charge of running the SHL's business. SHL had a client account with Daiwa Capital Markets Europe Ltd, an investment bank and stock brokerage company, ("the Bank"). SHL was placed into liquidation. In the lead up to its liquidation, Mr Al Sanea had provided instructions to the Bank, which the Bank had acted upon, to transfer various sums of money (amounting to c $204M) from the SHL's client account to accounts in the names of companies within a conglomerate in Saudi Arabia owned by him (SAAD Group).

Walker; (ii) an article written by Hugh Sims QC and Jay Jagasia for the Commercial Newsletter, 2017 Edition, entitled "What is left of Stone & Rolls?".

64. The money paid out was lost, and the liquidator's of SHL sought repayment by the Bank on the basis that various warning signs were present that indicated Mr Al Sanea's instructions may not have been bona fide.

Rose J's decision

65. Mrs Justice Rose allowed the claim. She found that the Bank was aware that the Company and the SAAD Group were in financial difficulty at the time it received unusual payment instructions from AS and that that knowledge and the unusual nature of the payment instructions should have put the 'reasonable banker' on notice that Mr Al Sanea was perpetrating a fraud. However, she reduced damages by 25% to reflect SHL's contributory negligence.

The Court of Appeal

66. On appeal, the Bank argued (inter alia) that it should not be subject to a *Quincecare* duty because: (i) SHL was precluded from bringing the claim because it was a "one man company" and thus the conduct and state of mind of Mr Al Sanea were attributable to SHL and consequently the claim should have been precluded by a defence of illegality (relying upon the dicta of the Supreme Court in *Jetvia SA & anr v Bilta Limited (in liquidation) & ors* [2015] UKSC 23); and (ii) The claim was precluded by the fact it was in reality being brought exclusively for the benefit of the creditors, not SHL itself (relying on passages in *Stone & Rolls*, as emphasising that a duty that is owed to the company customer is not owed to the creditors of the company . Sir Geoffrey Vos, Chancellor of the High Court, gave the leading judgment, with which the other members of the Court agreed.

67. As to (i) , the Court of Appeal dismissed the defence of illegality by concluding that the trial judge had applied the case law in this area correctly - the Company was not a 'one-man company' because the Company had other directors; and the conduct and state of mind of Mr Al Sanea could not be attributed to the Company because the other directors were innocent of the fraud and there was no evidence that could lead to a finding that they had been 'recklessly indifferent' to the behaviour of Mr Al Sanea.

68. As to (ii) the Court of Appeal took the view that the view that the scope of the *Quincecare* duty is narrow and well defined: the duty is owed to the customer to protect the customer against misappropriation of its funds, and if it is proven that a bank's breach of duty resulted in lost funds, that will be sufficient to prove a claim, regardless of who has in fact suffered as a result. It was unpersuaded that the identity of the party ultimately benefiting from that successful claim was a relevant factor.

Discussion - Quincecare

69. In assessing whether the *Quincecare* duty had been breached, the first instance judge (whose findings were not disturbed by the Court of Appeal) noted that the bank in this case was not acting as an ordinary deposit taking bank, but as a specialist stockbroker, and, consequently, it was reasonable to expect it to apply a higher level of scrutiny over payment instructions. We will have to wait and see whether the distinction the judge's comments draw on this point is used in future cases to found an argument that a bank providing specialist services owes a stricter *Quincecare* duty, potentially opening the door to more claims of this nature.

Discussion – attribution, Stone & Rolls and the "one man" company

70. Of wider interest however is the approach the Supreme Court is likely to take in relation to the questions of illegality and attribution. Most practitioners will be aware of the troublesome decision of the House of Lords in *Stone & Rolls*, above, where auditors successfully deployed a defence of illegality to stop in its tracks a professional negligence claim brought by a liquidator where the company in question was a "one man" company. That decision followed the earlier House of Lords decision in *Tinsley v Milligan* to the effect that a claimant cannot rely on his own illegal act to bring a claim. However, two Supreme Court decisions (*Bilta v Nazir* and *Patel v Mirza*) required reconsideration of what *Stone & Rolls* now establishes, if anything.

71. The decision in *Bilta* is particularly of note for the doubt it cast on the decision in *Stone & Rolls*. Lord Neuberger (with whom two other Lordships concurred) had the following to say, when referring to the third proposition identified by Lord Sumption (namely "as between a "one-man" company and a third party, the latter could raise the illegality defence on account of the agent's dishonesty, at any rate where it was not itself involved in the dishonesty"): '*While it appears that the third proposition, as extracted from three judgments in Stone & Rolls, would so apply, I have come to the conclusion that, on this appeal at least, we should not purport definitively to confirm that it has that effect. I am of the view that we ought not shut the point out, in the light of (a) our conclusion that attribution is highly context-specific..., (b) Lord Walker's change of mind..., (c) the fact that the three judgments in Stone & Rolls which support the third proposition are not in harmony..., and (d) the fact that the third proposition is in any event not an absolute rule*...' Lord Neuberger also stated agreement with the second proposition identified by Lord Sumption (namely that the defence did not apply where there were innocent shareholders), but beyond qualified support for the third proposition (as above), and approval of the second proposition, he (and two other Lordships) were unwilling to go beyond, stating: '*Subject to these points, the time has come in my view for us to hold that the decision in Stone & Rolls should, as Lord Denning MR graphically put it in relation to another case...be put "on one side in a pile and marked 'not to be looked at again' ". Without disrespect to the thinking and research that went into the reasoning of the five Law Lords in that case, and although persuasive points and observations may be found*

from each of the individual opinions, it is not in the interests of the future clarity of the law for it to be treated as authoritative or of assistance save as already indicated.'

72. That conclusion was reinforced by *Patel v Mirza* [2016] 3 WLR 399, where the Supreme Court jettisoned the *Tinsley* approach to illegality in favour of a more nuanced public policy approach. In assessing whether the public interest would be harmed, it was necessary to consider: (i) the underlying purpose of the prohibition which had been transgressed and whether that purpose would be enhanced by denial of the claim; (ii) any other relevant public policy on which the denial of the claim might have an impact; and (iii) whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment was a matter for the criminal courts.

73. You might have thought in these circumstances that *Stone & Rolls* would not feature again in argument, but it has arisen, yet again, in *Singularis* in the context of the debate as to what a "one man company" means and the law of attribution. In particular, the appeal in relation to attribution raises the following questions:

74. First, what is the test for a "one man company"? Is it: (i) a company where every single shareholder and director is implicated in the fraud, irrespective of whether the directors were involved in the management of the company at any point in time; or (ii) a company that is wholly owned and controlled by a fraudulent sole shareholder and dominant director and/or by the only person involved in the management and ownership of the company?

75. Secondly, upon whom does the burden of proof lie so far as the role of the other directors is concerned? Does it lie: (i) upon the company on whose behalf the directors acted at the material time; or (ii) upon the bank or broker?

76. In determining the question of attribution: (i) Is it relevant to consider whether the company had a legitimate business, and/or (ii) does the nature of the *Quincecare* duty lead to the conclusion that Mr Al Sanea's fraudulent knowledge should not be attributed to the Respondent?

77. If Mr Al Sanea's knowledge and fraudulent actions are attributable to the Respondent then the appeal raises a series of further questions concerning causation and the application of the three stage test identified by the Supreme Court in *Patel v Mirza* as referred to above.

78. It seems most likely the Court will endorse the view that the state of mind of a dishonesty director is only to be attributed to a company, for the purpose of potentially providing a third party with a defence of illegality, when there are no other innocent directors or shareholders, and this is the proper understanding of the phrase "one man company".

79. In *Meridian Global* [1995] 2 AC 500 Lord Hoffman emphasized that the key to any question of attribution is always to be found in the considerations of context and purpose. It seems likely that the Supreme Court will reaffirm this principle. This could provide the basis for a revival of the

speech of Lord Mance in *Stone & Rolls* to the effect that because it was an insolvent company this would be a proper basis for rejecting the attribution of knowledge of the guilty director. It should not, however, mean that simply because a company claim is brought for the benefit of creditors that should result in the court concluding a claim based on a duty to the company, as opposed to its creditors, is not justified.

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