STATES OF MIND

ACCESSORY LIABILITY

Claims against banks, trust companies and lawyers

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Introduction

1. The role of facilitators and intermediaries in fraud and their potential liability.

   1.1 Facilitators and intermediaries have a critical role. The services they provide enable fraud to occur: without them, in many cases, fraud would not succeed.

   1.2 Some examples: banks, lawyers, providers of fiduciary/company administration services, trustees, companies owned by trusts.

   1.3 Themes: compliance, culture, convergence, caution.

2. Accessories can become involved in fraud in different roles:

   2.1 **As service provider to the victim** – e.g. *Singularis Holdings Ltd v. Daiwa Capital Markets Europe Ltd* [2017] EWHC 257 (Ch) (currently on appeal):

   (a) Cases where the accessories facilitates or assists a fraud on its own customer, eg by paying out on the basis of instructions from an

authorised but dishonest director. The bank, trust company etc will owe contractual duties to the victim, as well as duties in tort.

(b) Potential conflict between a bank's duty to comply with its mandate (e.g. instructions given by an authorised company director) and the bank's duty where reasons exist to suspect fraud (e.g. suspicion that the director may be perpetrating a fraud); importance of notice.

Singularis Holdings v. Daiwa Capital ibid.

Barclays Bank v. Quincecare Ltd [1992] 4 All ER 363

Lipkin Gorman v. Karpnale [1989] 1 WLR 1340

Shah v. HSBC Private Bank (UK) Ltd [2010] Bus LR 1514

(c) The victim may not need to resort to dishonest assistance, with the requirement of proving dishonesty. There may be advantages in doing so, but there are also risks; see *Singularis* where the claim under the duty of care succeeded but the claim in dishonest assistance failed.

(d) Situations where an employee is dishonestly involved in the fraud on the accessory's customer

2.2 **As a service provider to the fraudster** (e.g. *Abou Rahmah v Abacha* [2007] Bus LR 220) by:

(a) Receiving money from the victim on behalf of the fraudster

(b) Money laundering

3. The accessory will owe no contractual duties to the victim, but contractual duties will be owed to its customer (notably to follow proper instructions). So the law strikes a balance between on the one hand protecting the victims of fraud, and on the other hand not stifling ordinary commercial transactions, particularly as regards banks: passim, but see especially:

Abou Rahmah v Abacha [2007] Bus LR 220

Tidal Energy v Bank of Scotland [2014] Bus LR 1167

This has an effect on the relevant state of mind of the relevant individuals; see comments by Gloster LJ in *UBS AG v Kommunale Wasserwerke Leipzig* [2017] EWCA Civ 1567 –"introducing into commercial transactions the moral standards of the vicarage"

4. A critical factor in almost all actions for accessory liability against any regulated organisation is going to be the degree of compliance with regulatory requirements and the organisation's own internal procedures in relation to anti-money laundering, KYC and EDD etc.

Abou Rahmah v Abacha [2007] Bus LR 220

Group Seven Ltd v Nasir [2017] EWHC 2466 (Ch)

Papadimitriou v Credit Agricole [2015] UKPC 13

Causes of action

5. The use of fraud, deceit, negligence, dishonest assistance and (in appropriate contexts) breach of contract as potential causes of action.

5.1 Deceit relatively unusual against facilitators.

(a) Not enough for bank liability if a dishonest employee provides a document (not itself a deceit) which a fraudster uses to deceive (or as part of a wider deception of) a third party – *Credit Lyonnais v. ECGD* [1998] 1 Lloyd's Rep. 19.

(b) There is no tort of knowingly assisting the commission of deceit. Liability for assisting the commission of a tort can only be imposed if the requirements for liability as a joint tortfeasor are made out – see now *Fish and Fish v. Sea Shepherd* [2015] UKSC 10; [2015] AC 1229

5.2 Negligence liability unlikely where the bank is banker to the fraudster – *Abou Rahmah v. Abacha* [2006] 1 Lloyd's Rep 484 (first instance). No duty of care in tort to avoid pure economic loss likely to be owed to a stranger. So in these cases, more likely that dishonesty may have to be alleged.

5.3 The most usual claims: proprietary claims, knowing receipt, dishonest assistance, unjust enrichment, inconsistent dealing, conspiracy.

5.4 Also rescission; *UBS AG v Kommunale Wasserwerke Leipzig* [2017] EWCA Civ 1567 - bribery case – test is whether the conscience of the third party was sufficiently affected – held that it was even though the third party did not know that a bribe had been paid by the claimant's agent**.** See also *Glenn v Watson*, judgment awaited.

6. In relation to knowing receipt or defence of bona fide purchaser for value in a proprietary claim, the requisite knowledge is now set out in *Papadimitriou v Credit Agricole* [2015] UKPC 13; note again the importance of the AML/KYC requirements and the importance of enquiry. Convergence of tests in relation to proprietary claim and knowing receipt.

7. Caution: can you prove the relevant state of mind? Many of the cases cited here were not successful in one way or another; salutary lesson in *Mortgage Agency Services Number One Ltd v. Cripps Harries LLP* [2016] EWHC 2483 (Ch); reference to putting on "*fraud detection spectacles".*

<u>Dishonest assistance</u>

8. What do you have to prove in dishonest assistance claims?

8.1 **Breach of trust or fiduciary duty**:

(a) What was the trust or fiduciary duty owed to the victim? If none, then no claim against the assistant

(i) No issue where the perpetrator was, for example, a director of the victim company or trustee of the trust of which the victim was the beneficiary – c.f. *Singularis Holdings v. Daiwa Europe* ibid.

(ii) No issue where the perpetrator holds assets on constructive trust for the victim (as a result of the fraud) but did not owe any prior duty: *Group Seven* at [408].

(iii) A fatal issue where the victim is simply deceived by the fraudster and the bank assists the deception – c.f. *Credit Lyonnais v. ECGD* ibid.

(b) No need for the primary breach of fiduciary duty to involve a misapplication of property by the fiduciary

Novoship (UK) Ltd v. Mikhaylyuk [2015] QB 499

(c) Not confined to money claims: can be used to found a claim for rescission: *UBS AG v Kommunale Wasserwerke Leipzig* [2017] EWCA Civ 1567.

8.2 **Dishonesty**

(a) The test – what is it? *Ivey v Genting Casinos (UK) Ltd* [2017] UKSC 67 at [62] endorsing *Barlow Clowes International v. Eurotrust International Ltd* [2005] UKPC 37; *Abou Rahmah v. Abacha* ibid. Two points to note:

(i) Criminal and civil tests for dishonesty now unified;

(ii) no longer any room for argument that *Barlow Clowes* did not represent the law of England and Wales on the basis that it is a Privy Council decision (*Willers v. Joyce (No 2)* [2016] UKSC 44; [2016] 3 WLR 534), if indeed there was room for any such argument: see *Seven Ltd v Nasir* [415];

(b) The test in practice – *Central Bank of Ecuador v. Conticorp SA (Bahamas)* [2015] UKPC 11; [2016] 1 BCLC 26; *Group Seven Ltd* (above).

(c) Wilful blindness (i.e. deliberately turning a blind eye) will amount to dishonesty – *Royal Brunei v. Tan* ibid.; *Singularis Holdings v. Daiwa* ibid.

(d) Recklessness is not *per se* dishonesty, but it may be evidence of dishonesty – *Clydesdale Bank PLC v. Workman* [2016] PNLR 18; can this really be right?

(e) Motive for dishonesty is a significant consideration, including a culture which conduces to dishonest behaviour - *Clydesdale Bank PLC v. Workman* ibid.; *Mortgage Agency Services Number One Ltd v. Cripps Harries LLP* [2016] EWHC 2483 (Ch) at [88]; FCA Financial Crime handbook 2016 p 43; sales incentives, remuneration

structures, blame culture, hiding of losses, lack of information to senior managers so reduced risk to assister.

(f) No need for the assistant to know of the existence of the trust or fiduciary relationship – *Royal Brunei Airlines v. Tan* [1995] 2 AC 378; *Barlow Clowes International v. Eurotrust International Ltd* [2005] UKPC 37; but (in a misappropriation case) the court should examine what the defendant knew or suspected about the ownership of the assets in question and what it knew or suspected about the principal wrongdoer's right to use those assets (compare the decision that Mr Landman was not dishonest in *Group Seven*).

(g) Dishonest actions of the defendant that were causal of the acts complained of (e.g. a solicitor dishonestly acting in breach of the Solicitors Accounts Rules causing a dissipation of trust funds) are insufficient; the defendant must have the relevant knowledge as to there being a breach of trust: *Group Seven* at [471].

(h) But where a party is found to be providing dishonest assistance, then its conscience may be affected not merely by the particular form of abuse by the fiduciary of which it actually knew, but also by another other abuse which the agent chooses to employ: *UBS* at [113] (but note dissenting judgment of Gloster LJ [339]-[352], so a possible Supreme Court point in due course).

8.3 **Assistance**

(a) Question of fact – categories not closed

(b) Various examples: *Dubai Aluminium v. Salaam* [2003] 2 AC 366 (solicitor drafting an agreement used by others in an improper scheme); *Madoff Securities International Ltd (In Liquidation) v. Raven* [2013] EWHC 3147 (research; submitting invoices; collecting cheques); *Novoship (UK) Ltd & ors v Nikitin & Ors* [2014] EWCA Civ 908 (conducting negotiations which had some prospect of resulting in a contract); *Group Seven* (multi-disciplinary practice allowing its client account to be used as a bank account for a fraudster).

(c) Mere acquiescence or omissions to act are unlikely to be enough, but query – see Lord Nicholls in *Royal Brunei v. Tan* [1995] 2 A.C. 378

9. Attributing an individual's state of mind to a company or other organisation

9.1 Vicarious Liability

(a) Yes, in the context of the Partnership Act 1890 – *Dubai Aluminium v. Salaam* [2003] 2 AC 366

(b) "close connection" test – *Dubai Aluminium* ibid.; *Mohamud v Wm Morrison Supermarkets plc* [2016] AC 677

(c) Application in the case of a bank: *Group Seven* at [537].

9.2 Attribution

(a) The process of legal reasoning by which the conduct or state of mind of natural persons is treated as that of a non-natural person for the purpose of determining legal liability or legal rights – *Moulin Global Eyecare Trading Ltd v. Inland Revenue* (2014) 17 HKCFAR 218, *Meridian Global Funds Management Asia Ltd v. Securities Commission* [1995] 2 AC 500 (PC); endorsed in *Bilta v. Nazir* [2016] AC 1, expanded in cases against accomplices/co-conspirators in *UBS* at [150]-[152] on the basis that the same policy considerations apply.

(b) Where appropriate, knowledge and/or acts of dishonesty/fraud will be attributed to a legal person – e.g. *Financial Conduct Authority v. Da Vinci Invest Ltd* [2015] EWHC 2401 (Ch); *Mobile Sourcing v. HMRC* [2016] UKUT 274.

(c) Court of Appeal's observation in *UBS* at [185] of a possible tension where a company may be vicariously liable for a fraudulent statement made by a director in circumstances where the director's knowledge of the truth is not attributed to the company; while it was accepted at [126] that the same director's knowledge that the agent was not providing disinterested advice to the claimant was not attributable to the claimant: *"It may be that the law as to vicarious liability and attribution run in different channels"*

9.3 Agency

(a) Discussion of whether bribing party was agent of third party bank in UBS at [79] to [102]: claim in agency unsuccessful in the Court of Appeal.

(b) Where a trust company permits a settlor to carry out business and then insert a completed deal into a trust, but the business has been procured dishonestly; look out for judgment in *Glenn v Watson* (judgment awaited)

10. Dishonest assistance and knowing receipt; requisite knowledge/notice in each case; does *Papadimitriou v Credit Agricole* [2015] UKPC 13 represent a move towards assimilating the test in relation to the two? Back to *Barnes v Addy* (1873-74) L.R. 9 Ch. App. 244? For the time being at least, still being considered separately at first instance, with differing results: *Group Seven.*

Practical considerations for clients who might become defendants and for practitioners

11. For clients:

11.1 Do not be a puppet for your client – be alert and sceptical.

11.2 Culture; can you show that steps have been taken to address the kind of matters identified by the FCA?

11.3 Ensure all those working on a client's affairs are aware of the client's history and instructions, and any early identified concerns, so that they can put developments in context.

11.4 If a client is evasive or refuses to answer questions, persist in asking until you are satisfied with the explanation. Do not just accept anything you are told and do not disregard inconsistent explanations or explanations which contradict documents or other facts known to you.

11.5 Seek external legal advice or advice from your regulator if in any doubt as to the scope of your AML/client DD obligations.

11.6 Carefully document all steps taken to comply with AML and client DD obligations and any internal policies and procedures, and ensure continuing obligations are complied with.

12. For practitioners:

12.1 If considering a potential claim against a regulated entity with AML and client DD obligations, consider obtaining early access (whether by way voluntary disclosure under a pre-action protocol, by way of a pre-action

disclosure application, by way of a s236 IA application if advising an office-holder) to:

12.2 that entity's AML/DD file;

12.3 any compliance manuals and/or internal policies and procedures (for banks in particular, these will set out the level of scrutiny required of transactions, account activity and customers in different circumstances, the "red flags" to look out for and report and the continued monitoring required of high risk designated customers)

12.4 details of the financial benefit/profit derived from the relationship with the client/customer (e.g. for banks, the fees taken for operating the account).

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