SHARE SALE FRAUD – spreading the net

A workshop led by Rupert Reed QC, David Drake and Jonathan Tickner

ISSUES FOR CONSIDERATION

A. What claims may GAL have against *Arthur*?

A.1 If the fraud can be shown, so that the SPA is voidable, then GAL would ordinarily be entitled to restitution of the monies paid by it under the SPA, assuming that the SPA can be set aside. However, setting aside the SPA will probably only be possible if each of Brandon, MFL and Archie can be shown either to have been privy to Brandon's fraud in some way, or to have had constructive notice of it. Even then, GAL could (if tracing is possible) obtain from Arthur no more than the USD 1m paid to him, and possibly restitution of the 'use value' of the money in a sum likely to reflect commercial interest rates. Further, Arthur would have a defence of change of position in respect of the monies spent on a holiday, and GAL would need to join his children as Defendants in order to claim restitution of the monies given by Arthur to them.

A.2 If GAL were to pursue a claim in restitution that require the SPA to have been avoided, it would want to consider how its prior rescission of the SPA may impact on any warranty claims of greater quantum that may require the SPA to remain in force.

A.3 In practice, the warranties given by Arthur are likely to have included warranties in respect of BTL's management accounts or the accuracy of other management information provided to GAL. The loss of USD 2m in book debts from the balance sheet of BTL will almost certainly be a breach of any such warranty.

A.4 The advantages of the warranty claims include that: (i) there is no requirement to prove any mental state on the part of Arthur; (ii) there is likely to be a contractual representation by Arthur that he relied on the warranties (by which Arthur is estopped from denying reliance); and (iii) there may further be express contractual provision that Arthur is jointly and severally liable for any breach of the warranties.

A.5 The disadvantages of the warranty claims include that: (i) the ordinary measure of loss is the difference between the actual value of the property acquired in reliance on the warranty and its value if the warranty had been true, and the Court's starting point is likely to be the balance sheet position of BTL; and (ii) the warrantors may have expressly limited their liability for any breach of warranty claims (often to the amounts they have received), for example by contractually severing the warranties given by the various sellers or limiting the amounts of any warranty claims.

A.6 Such limits are unlikely to apply to fraud claims. The Courts tend to be indulgent to claimants on issues of causation and remoteness. GAL's headline claim would be for all of the USD 6 m in losses it made as a result of acquiring BTL. These losses may include legal and professional costs, finance costs and penalties, losses consequential

on GAL's loss of credit, and even introduction fees, success fees and bonus fees paid to members of GAL's management insofar as unrecoverable.

A.7 Moreover, if GAL could show, on very compelling evidence, that it would otherwise have acquired some other business and made significant profit, then it could further claim its loss of profit.

A.8 Brandon's fraud seems clear. The issue is then whether Arthur can be found liable for the fraud of Brandon.

A.9 The starting point is usually to ask whether Arthur was 'vicariously' liable for the fraud of Brandon; but vicarious liability would depend on Brandon acting as or in a role analogous to Arthur's employee – unlikely to be the case here. The next step is to move on to an *agency* analysis as to whether Brandon, in giving the relevant information, was acting with the authority of Arthur and within the scope of that authority: *Bowstead & Reynolds on Agency*, 20th edn, 2014, 8-177. It is important to carry out that analysis early in the case so that it can be properly pleaded and GAL can focus on identifying the right evidence.

A.10 If there was *express* authority, then the principal's liability is not 'vicarious' at all. It is unlikely that Brandon had any *express* authority to provide information on behalf of Arthur – Arthur will say that throughout the period when the meetings took place he was himself acting as agent for UHL, not as a principal; but this may be undercut to the extent that he treated the shares in BTL as his own. Emails from Arthur's UHL email account might shed further light on these issues. Given that Brandon has disappeared, there is no prospect of him giving evidence that Arthur orally instructed him or asked him to provide any relevant information to GAL on Arthur's behalf.

A.11 On the facts of this case, it would be worth seeking disclosure of Arthur's email traffic with Brandon, and of the power of attorney under which Arthur authorised Brandon to sign the SPA. Given the eleventh-hour reorganisation within UHL, the scope of that power may have been widely drawn for example in authorising Brandon to do all necessary to procure the sale of the shares under Arthur's indirect ownership and control. Alternatively, it may be limited to the mere execution of documents to effect the sale.

A.12 If there were express authority, then GAL will be able to rely on *Briess v. Wooley* [1954] AC 333. The Court in that case had to consider whether shareholders who expressly authorised a dishonest director to negotiate with purchasers were liable for deliberate concealment that pre-dated the authorising resolution but continued. It was implicit in the Court's reasoning that the shareholders were liable for misrepresentations by a director expressly authorised by the shareholders. The express authorisation in that case was a resolution by all of the shareholders.

A.13 It is more likely that the Court will find some form of *implied* or *apparent* authority in considering the circumstances of each of the meetings. If it found that there was implied authority, then there would be a strong case for the application of *Briess v.*

Wooley, insofar as both express and implied authority are forms of *actual* authority, and there is no principled reason for distinguishing them.

A.14 In the case of *implied* authority, the Court considers the dealings between Arthur and Brandon in order to determine whether there was an implied agreement between them that Brandon would provide information on behalf of Arthur. Some think that the test for any implied agreement has probably become stricter with that for an implied term after *M&S v. Parisbas* [2015] UKSC 72 [2016] AC 742. Is an implied agreement *necessary* to make sense of Arthur and Brandon's relationship? Is an implied relationship necessary to serve their common purpose of selling BTL?

A.15 In the case of *apparent* authority, there was no actual authority, but the Court considers the dealings between Arthur and GAL in order to determine whether Arthur held out Brandon to GAL as having his authority to provide information. Apparent authority tends to be found in the case of professionals acting for a vendor, such as estate agents or solicitors answering inquiries: *Bowstead & Reynolds on Agency*, 20th edn, 2014, 8-182.

A.16 Another approach to tortious liability for misrepresentations is to consider whether Arthur assumed responsibility for the statements of Brandon, and GAL relied upon that assumption of responsibility: *Bowstead*, 8-177.

A.17 Arguably agency is a contractual proxy for an assumption of responsibility. Where statements are made in the scope of an agent's authority, it it likely that the principal assumed responsibility for their accuracy: see *Williams v. Natural Life Health Foods Ltd* [1998] 1 WLR 830. To that extent, tortious liability, based on an assumption of responsibility, should closely parallel contractual liability, based on agency: *Bowstead*, 8-180 to 8-182. While the Courts most often consider whether there has been an assumption of responsibility in the case of negligent misstatement, it is increasingly used in wider circumstances.

B. What about a claim against MFL?

B.1 Even if it did appear in due course that MFL had assets, It is doubtful whether any claim is viable against MFL. It never authorised Brandon (or Arthur or Archie) to act on its behalf during the brief period between its incorporation and execution of the SPA. It could not ratify acts prior to its incorporation – and indeed it did nothing outward to 'adopt' any misrepresentations that might have been made before its incorporation. Accordingly, it seems difficult to argue that it is liable for Brandon's fraud; or that there was any assumption of responsibility on its part for representations that had been made.

B.2 Equally, it seems difficult to argue that MFL was privy to Brandon's fraud, or had constructive notice of it, so as to allow the SPA to be rescinded – thus preventing any restitutionary claim against MFL.

B.3 Furthermore, MFL did not give any warranties. (Even if it had done, whether breach would follow would depend on the content of the warranty. Any warranty in the nature of a promise that no misstatements had been made in the accounts of which the warrantor ought with reasonable care to have been aware might not have been breached, because of the short window of opportunity for making investigations between MFL's incorporation and the execution of the SPA.)

C. Can GAL get disclosure of material from Arthur's email account?

C.1 Arthur's disclosure obligations are limited to documents in his control: CPR r 31.8(1). Arthur, is neither in possession of the email documents, nor does he have any right to possess them or inspect them (the conditions set out in CPR r 31.8(2) for satisfying the requirement of control) – whatever arrangements UHL had with SML, Arthur gave up any rights he had when he stepped back from UHL.

C.2 But this analysis does not conclude the question of control, because 'control' has been held to be a question of fact – which may be satisfied even if the requirements in CPR r 31.8(2) are not: see *North Shore Ventures Ltd v Anstead Holdings Inc* [2012] EWCA Civ 11, [40]. If, for example, SML extends assistance to Arthur during pre-action correspondence by granting him access to his email documents, the adoption of that practice may be sufficient for the court to infer the existence of a more general practice or relationship, sufficient to treat the documents as within Arthur's control: see *Schlumberger Holdings Ltd v Electromagnetic Geoservices* [2008] EWHC 56 (Pat).

C.3 Alternatively, GAL could apply for third party disclosure from SML under CPR r 31.17. GAL would need to specify particular documents (such as the power of attorney) or classes of document (r 31.17(4)(a)) each of which is likely to support its case or adversely affect another party's case (r 31.17(3)(a)), but "likely to support … or adversely affect" for these purposes means "may well" support or adversely affect (*Three Rivers DC v Bank of England (No 4)* [2003] 1 WLR 210) – a point often of practical importance in particular where a class of documents is sought. The class must be defined in a way that SML can carry out mechanistically, without any requirement to discover or understand the issues in the case (see *Constantin Medien AG v Ecclestone* [2013] EWHC 2674 (Ch), [66]-[67]) – so a class defined as "emails relevant to the issues in dispute" would not be adequate, but one defined as "emails relating to any of the presentations made to GAL", or "emails evidencing any grant by Arthur to Brandon of authority to present information to GAL" would be adequate.

D. How would those claims be made by reference to each of the Shoreditch, Soho and Broadway meetings?

The Shoreditch Meeting

D.1 GAL will struggle to show any authorisation or assumption of responsibility by Arthur at the Shoreditch meeting. The meeting has a social flavour, and there was no discussion of any of the detail of BTL's contracts or financials. Indeed, Arthur went out of his way to disclaim any knowledge of these, so it will be harder to say that

Brandon was later providing specific information on Arthur's behalf. The relevant authorisation or assumption of responsibility would have to relate to a broader class of management and financial information.

D.2 GAL's best argument is that, in circumstances where the shares of both Arthur and Brandon were up for sale, Arthur's implicitly leaving it to Brandon to provide such information as may be required by GAL constituted a conferral of authority. That 'leaving it to' Brandon can be presented as an implied conferral of the relevant authority or holding out for the purpose of establishing that Brandon had apparent authority.

D.3 The test for implying an agency agreement between Arthur and Brandon is likely to be one of strict necessity. However, necessity has to be assessed against a particular objective. If the relevant necessity is to give sense to their business relationship, then it cannot be said that authority to provide the relevant information is necessary to that object. If, however, the relevant necessity is to give effect to the parties' common purpose, then GAL have a stronger argument by reference to the purposes of selling BTL.

D4. The difficulty in relying on this meeting is that a conferral of authority, holding out or assumption of responsibility are all assumed to be by way of statements or positive acts, and not silence or the absence of any action, as appears to have been Arthur's position at this meeting. A principal can silently or passively acquiesce in an agent's holding himself out as having authority, but there is no evidence of that here.

The Soho Meeting

D.5 This meeting at BTL's offices has a clearer business focus, and there is a reasonable expectation that GAL will want to inspect and discuss relevant documentation. Arthur will find it harder to rely on his absence in circumstances where he has expressly 'left it to Brandon' to provide detailed information.

D.6 To the extent that Arthur emails Chuck after the meeting, even only in expressing pleasure at their meeting, this may be presented as some form of ratification where it was implicit that Brandon had reported to Arthur on the continued meeting.

The Broadway Meeting

D.7 GAL's case is significantly strengthened by the facts of this meeting. It was evident from the presence of GAL's senior management and DDL that the focus of the meeting was on the business and financial position of BTL. Arthur's introduction of Brandon's presentation evidences an implied authorisation and further appears to hold out Brandon as having authority to provide detailed company information.

D.8 Arthur attended throughout the presentation and he failed to correct the relevant statements as to BTL's clients, contracts and financial position, and even purported to be able to take questions on them. GAL could present this in two ways.

D.9 First, it could be said that Arthur's acquiescence in Brandon's acting as if he had authority to provide information on behalf of all of the shareholders by itself constituted an implied representation that Brandon had that authority. In *Freeman & Lockyer v. Buckhurst Park Properties* [1964] 2 QB 480, an invalidly appointed managing director acted as if he was the managing director having authority to represent the company. The Board, by its acquiescence in this, was found to have made an implied representation for the Company as to the authority of the managing director so that the Company was estopped from denying it. There may, however, be issues as to whether Brandon made any representation as to his own authority to provide information on behalf of all of the shareholders, or indeed whether GAL reasonably relied on any implied representation by Arthur. Brandon's conduct is entirely consistent with his making representations on his *own* behalf.

D.10 Secondly, it could be said that Arthur, by his words at the end of the presentation expressing apparent approval was further or alternatively ratifying the presentation and holding out Brandon as having been speaking for both of them.

D.11 Another potential route for GAL to establish Arthur's liability by asking whether he can be taken to have assumed responsibility for the actions of Brandon as his agent. That assumption of responsibility is easier to establish where Arthur introduced and attended the presentation in circumstances where he appeared to approve of its contents and himself to have the knowledge necessary for him to do so.

E. How might GAL seek to show its reliance on the presentation?

E.1 GAL needs to show its reliance on both:

(1) any implied representation by Arthur as to Brandon's authority or holding out by Arthur of Brandon as being Arthur's agent for the purpose of the estoppel that founds apparent authority; and

(2) the fraudulent misrepresentations made on Arthur's behalf for the purpose of showing that Arthur is jointly and severally liable for all of GAL's losses flowing causally from the deceit.

E.2 In practice, the first will require GAL to emphasise the importance to GAL of Arthur's approval and endorsement of the relevant information presented by Brandon. This could be by emphasising the relative inexperience and lack of track record on the part of Brandon, in contrast with the experience and reputation of Arthur.

E.3 The second is likely to be a more objective analysis. GAL will want to show that it would not have proceeded at all with the purchase of BTL. Insofar as it used finance, it may, for example, show that its financier would never have advanced any money for the purchase of a company that would have been balance sheet insolvent. It may similarly identify other UK businesses in the relevant market whose acquisition would have served its specific strategic interests that it would have bought had it known the

true position in respect of BTL. In those circumstances, GAL would compare its preference for BTL on the basis of the fictitious information with its preference for any alternative targets on the basis of the true information.

E.4 One difficulty that GAL may face on the issue of reliance will be whether it reasonably relied on a PowerPoint presentation giving critical information as being commended by Arthur in circumstances where:

(1) Arthur expressly disclaimed any detailed knowledge of the company, its business and its finances;

(2) GAL attended BTL's offices in Soho in order that it could inspect any documents which it considered to be of particular importance;

(3) GAL's own lawyers, Innovative Law LLP, and its accountants, DDL, had spent significant time and were paid significant sums in order to carry out extensive legal and financial due diligence;

(4) The misrepresentations followed from fictitious receivables which on any proper due diligence would have been discovered by proper inquiries of the debtors;

(5) To the extent that the receivables were not considered in the due diligence, the failure of GAL to raise this with the relevant professionals does not suggest that GAL's decision to acquire BTL was based upon those receivables.

E.5 Arthur may further respond on reliance that BTL's business was built on a single individual, Brandon, who impressed the senior management of GAL not with the net assets of his company, as evidenced by the fact that they spent USD 10m on a company with net assets of less than USD 2m. Alternatively, Arthur may be able to show that BTL was the only company that GAL could reasonably have acquired in order to achieve a UK presence in the relevant global advertising market.

E.6 However, it is likely that the SPA contains a contractual statement that GAL has relied on the warranties. To the extent that the representations were co-extensive with certain of the warranties, GAL may be able to rely on the contractual statement of reliance. That statement operates by way of a so-called "contractual" estoppel, and so GAL would not need to show that they had themselves relied on Arthur's agreement regarding GAL's reliance.

E.7 Arthur may be able to respond to this by arguing that where certain facts are the subject of *warranties*, there is a presumption that the purchaser was not relying on them in entering the contract. This is because if the statement is found to be untrue, the purchaser cannot avoid the contract, but is restricted to its claim in damages. In other words, the warranties are of matters implicitly *not* critical to the purchaser.

F. What claims may *HAL* have against Arthur?

F.1 Again, HAL may have limited restitutionary and warranty claims.

F.2 A principal may be liable for the representations of its agent within the scope of that agent's authority, even where the representation reached the claimant by way of an innocent agent or 'conduit': see *Armstrong v. Strain* [1952] 1 KB 232 (third 'proposition'). In this case, HAL would be looking to show that the representations made at the Shoreditch, Soho and Broadway meetings had reached it, for example because GAL and HAL were at the time acting together, and Arthur would have known that those representations were likely to reach HAL.

F.3 It is further arguable that HAL can identify the different elements of deceit in different individual actors, here Archie who made the relevant representations in giving Brandon's presentation and Brandon who knew them to be untrue. In *Occidental Worldwide Investment Corp v. Skibs A/S Avanti ('The Siboen and the Sibotre*') [1976] 1 Lloyd's Rep 293 at 321, Kerr J endorsed the view that 'if one agent makes a statement honestly believing it to be true, but another agent knows that it is not true, knows that the statement will be or has been made, and deliberately abstains from intervening, the principal will be liable. This goes beyond the propositions made in *Armstrong v. Strain*, but appears to have been endorsed in turn by Males J in *UBS AG v. Kommunale Wasserwerke Leipzig GmbH* [2014] EWHC 3615 (Comm) at [754]-[760]. Since the elements are not united in a single agent, this rule cannot be explained on the basis of vicarious liability, and may involve some special rules of attribution that have yet to be articulated.

G. Would you advise GAL to consider seeking a summary determination?

G.1 There would be some advantages of seeking summary judgment:

(1) There would be significant cost savings in avoiding standard disclosure and the costs and wasted management time of a full trial;

(2) The difference between that potential cost saving and the relatively low cost and cost exposure of making an application for summary judgment may be sufficient for you to advise in favour of applying even if the prospects of success are low;

(3) A summary determination on documents may mitigate the judicial sympathy for him that is likely to result from his being called at trial to give evidence.

G.2 At its simplest, GAL's case is that it was implicit in Arthur's selling his shares on the basis of representations that he knew Brandon to be making, that Brandon was acting on Arthur's behalf. That could be the narrow basis of a claim of implied authority in contractual terms or an assumption of responsibility in terms of tort.

G.3 GAL would no doubt seek to agree the facts of the relevant meetings in order to provide a broader basis for its claim of vicarious liability.

G.4 Arthur would no doubt oppose GAL's application by arguing that inquiries as to implied authority, apparent authority, the assumption of responsibility and reliance are inevitably fact-sensitive. The Court will arguably need to conduct a wider multi-factorial inquiry in order to see the relevant facts both in some detail, for example as to precisely what was said, and in a wider context.

G.5 In terms of reliance, GAL is going to need to show not only reliance on the relevant misrepresentations in terms of causation, but prior to that reliance on any holding out by Arthur of Brandon as having authority to provide the relevant information on Arthur's behalf. There are therefore layers of necessary reliance, each of which needs to be established on the relevant fact and evidence.

G.6 At the heart of that inquiry as to reliance is the issue of why GAL acquired this company. There is likely to be significant disclosure on GAL's side that is relevant to that issue, not least of internal management documents such as Board papers, dealing with the proposed acquisition of BTL.

G.7 As for any warranty claims, these often raise issues of construction, for example where there is a contractual limitation said to apply in cases of fraud 'by the Sellers', so that it is not clear whether the relevant fraud needs to involve all of the sellers. Such issues of construction need to be determined by reference to the factual matrix and, in cases of ambiguity, by reference to commercial common sense.

G.8 It may further be difficult for GAL to prove its consequential losses and even any loss of profits before trial. It could, however, seek summary judgment on liability.

H. Is this all unfair on Arthur? Does that matter? What arguments can GAL advance in seeking to mitigate any potential unfairness?

H.1 Arthur will present a powerful defensive case on the non-legal 'merits':

(1) He had no part in the day to day management of BTL, including its contracts and accounting, as he was only a non-executive director;

(2) He never himself made any of the relevant representations and had no idea they were fraudulent, so that he was 'as much a victim' of Brandon's fraud;

(3) He made it clear to GAL that he was no more than a non-executive director; and

(4) The real fault here was that of DDL for the obvious failings in its due diligence.

H.2 In litigation, in particular in seeking interim orders such as freezing injunctions and summary judgment, these arguments may be important in moving the judge even if they are not necessarily relevant to the specific causes of action relied upon.

H.3 GAL may seek to undermine the prejudice of these points, arguing for example that:

(1) Arthur had been looking to turn a profit of 1900% over a short holding period, and knew that the investment he was making was inherently high risk;

(2) Arthur's scrutiny of BTL's affairs was in breach of his fiduciary and common law duties, not least that of reasonable skill, care and diligence;

(3) But for that breach, it is likely that Brandon's frauds would have come to light;

(4) GAL relied significantly on the obvious integrity of Arthur as a banker with an unblemished reputation; and

(5) Arthur may bring his own contribution proceedings against Brandon under the Civil Liability (Contribution) Act 1978 against Brandon as a joint tortfeasor to recover a 100% contribution. He may be better placed to locate both Brandon and Brandon's assets, and so the loss should lie at first on him.

H.4 The better view is that GAL should *not* seek to insinuate that the sale was 'too good to be true', or that Arthur was complicit in the fraud or turned a blind eye to it. Judges tend to react negatively to insinuations of fraud made without any basis.

Rupert Reed QC
Serle Court Chambers

David Drake
Serle Court Chambers

Jonathan Tickner
Peters & Peters