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Illegality, one-man companies and supine directors
Singularis Holdings Ltd (In Official Liquidation) v Daiwa Capital Markets Europe Ltd
[2018] EWCA Civ 84

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Introduction

The decision of the Court of Appeal in *Singularis* dealt with the difficult issue of the circumstances in which the knowledge of a sole shareholder and dominant director, who had committed a fraud on the company, should be attributed to the company when the company in turn was suing a bank for breach of contract and negligence in facilitating the fraud. The follow-on issue was whether, if that knowledge was attributed to the company, the defence of illegality was available to allow the bank to defeat the claim in negligence and breach of contract brought by its corporate customer on the basis that the company could not benefit from its own fraud. The first instance judge had dismissed both grounds of the bank's defence.

The facts

The claimant S Ltd had been incorporated in the Cayman Islands to manage the personal assets of AS, its sole shareholder and dominant director who had substantial interests in associated companies. The defendant D Ltd, the London subsidiary of a Japanese investment bank, entered into a global master securities lending agreement with S Ltd to allow it to buy shares that, in turn, acted as security for the loan. During the financial meltdown, when D Ltd learned that AS's assets had been frozen in Saudi Arabia, it required S Ltd to sell the shares and repay all outstanding sums loaned so that by June 2009 S Ltd's client account was USD$200m in credit. Two months later, as a result of eight requests made by AS to D Ltd for payment to companies with links to AS, the balance had been reduced to zero. The repayment requests had been scrutinised by D Ltd's compliance department after making enquiries of a connected company which provided advisory and investment services to D Ltd. In August 2009 AS, in his capacity as sole shareholder, placed S Ltd in voluntary liquidation and, following a petition by one of S Ltd's creditors, the liquidation proceeded under the supervision of the Grand Court of the Cayman Islands.

Five years later S Ltd, acting by its liquidators, issued a claim for USD $200m on two grounds, first, that D Ltd had dishonestly assisted AS's breach of fiduciary duty by removing the money from S Ltd for the benefit of himself and to the detriment of creditors and, secondly, that D Ltd breached its duty of care to S Ltd by authorising payments having negligently failed to realise that AS was committing a fraud on S Ltd and misappropriating its money.

The law

Barclays Bank Plc v Quincecare Ltd [1992] 4 All E.R. 363 established that a bank owed a duty to take reasonable care in and about executing a customer's orders (commonly referred to as the Quincecare duty). Steyn J said at 376–377 that

> "a banker must refrain from executing an order if and for as long as the banker is 'put on inquiry' in the sense that he has reasonable grounds … for believing that the order is an attempt to misappropriate the funds of the company".

The standard was that of an ordinary prudent banker although everything depended on the particular facts of the case. In *Lipkin Gorman v Karpnale Ltd* [1989] 1 W.L.R. 1340, Parker LJ said at 1377–1378 that the test had to be whether, if a reasonable and honest banker knew of the relevant acts, he would have considered that there was a serious or real possibility, albeit not amounting to a probability, that its customer might be being defrauded; in those circumstances a reasonable banker would be in breach of duty in continuing to pay cheques without inquiry.

In *Patel v Mirza* [2016] UKSC 42, the Supreme Court held at [120] that the essential rationale of the illegality doctrine was that it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system; assessing whether the public interest would be harmed required consideration of whether denial of the claim would be a disproportionate response to the illegality judged against the harm to the integrity of the legal system.

The leading authority on attribution in the context of the illegality defence is *Bilta (UK) Ltd (in liquidation) v Nazir (No.2)* [2016] A.C. 1 (and see 2016 S.L.T. (News) 65 and 73). The answer to the attribution question depended on the context and purpose for which attribution was contended. Although Lord Sumption said that at [91] that:

> "For a person, whether natural or corporate, who is culpable of fraud to say to an innocent but negligent outsider that he should have stopped him in his dishonest enterprise is as clear a case for the application of the illegality defence as one could have."

Although a company could only act through natural persons, the acts of fraudulent dominant directors were not necessarily attributed to the company. The Supreme Court was divided on the proper test: the majority defined a one-man company as "a company in which, whether there was one or more than one controller, there were no innocent directors or shareholders" whereas the minority defined it as

> "a company which has no individual concerned in its management and ownership other than those who are, or must (because of their reckless indifference) be taken to be, aware of the fraud or breach of duty".

First Instance decision

At first instance Rose J ([2017] 1 B.C.L.C. 625) held that AS was in breach of his fiduciary duty to S Ltd by misappropriating its money and, because he must have known that S Ltd was insolvent or verging on insolvency so that his duty to act in the best interests of creditors was engaged, he was precluded from ratifying the payments as its sole shareholder. The judge rejected the dishonest assistance claim, finding that D Ltd's employees simply had not understood what they had to do in order for D Ltd to fulfil its obligations to S Ltd because management had not properly explained it to them. She held further that D Ltd owed the *Quincecare* duty to S Ltd (and separately that it was irrelevant that only S Ltd's creditors, to whom the duty was not owed, had suffered a loss because the claim had been brought by S Ltd) which it had breached by making the payments without any proper inquiry. Any reasonable banker would have realised that there were many obvious signs that AS was perpetrating a fraud on S Ltd but D Ltd had a "dysfunctional structure" leading to a sequence of events where everyone assumed someone else was investigating the disputed payments but did not check that that was the case.

The judge also held that, if AS's fraud could be attributed to S Ltd in order to defeat the claim, that would denude the duty of value in situations where it is most needed. More specifically the judge found that S Ltd was not a "one-man" company in the *Bilta* sense because it had other directors, including professional and experienced businessmen who were not relatives of AS; on the evidence it had not been possible to find either that they had exercised any influence over the management of S Ltd or that they had been complicit in the fraud. In the absence of attribution the illegality defence failed. The judge held that the public policy behind the illegality defence did not require its application in these circumstance and rejected D Ltd's defence that it has an equal claim in deceit against S Ltd which was vicariously liable to AS's fraud because D Ltd's breach of duty was the cause of its liability and not AS's fraudulent misrepresentations. Since almost any negligence case based on a failure to detect fraud would deception by the fraudster, it would be defeat the purpose of the duty if the negligent party had an automatic and complete defence to any negligence claim by bringing a counterclaim in deceit.

The Court of Appeal

D Ltd appealed against the decision on attribution, arguing that the judge had been wrong to find that S Ltd was not a one-man company. None of the other directors had played any role in the management of the company (they were "supine") so, if AS's knowledge was not to be attributed to S Ltd, whose knowledge could be attributed since the law did not permit it to be a mindless automaton. D Ltd also argued that the *Quincecare* duty did not apply where only the creditors of S Ltd, to whom a duty was not owed directly, stood to benefit and that the judge had been wrong to reject the defence in deceit.

On the attribution issue, Sir Geoffrey Vos, Chancellor of the High Court, with whom Gloster and McCombe LJJ agreed, said that as the judge had not found that the other directors were complicit in the fraud, the majority *Bilta* test was not satisfied. Even if the minority test was applied, the burden was on D Ltd to show that S Ltd's other directors played no role in its management, which it had failed to do because the judge had made no finding on whether the other directors had exercised any influence over the management of S Ltd at [54]–[55]. In addition, S Ltd was not a sham company incorporated solely for the purpose of the fraud but a genuine company which had carried out legitimate transactions. The fact that the instructions to transfer the money had come from AS, a person entrusted by S Ltd as a signatory on the bank account, meant that the duty was to save the company from the fraudulent conduct of that trusted person.

To attribute AS's knowledge to S Ltd would denude D's Ltd duty of any value where it was most needed.

At [59] the Chancellor said that he did not find the expression "one-man company" helpful. While the knowledge or conduct of a shareholder might depending on the circumstances be attributed to the company, the starting pint should not be whether the company fitted "within the parameters of various competing definitions of the term 'one-man company'" but rather with a detailed consideration of the factual context, the nature of the claim being made, and the purpose for which the attribution was sought.

The Chancellor added that, even if the illegality defence could be relied on because AS's fraud was attributed to S Ltd, the judge had made no error in her application of the principles in *Patel v Mirza* so that an appellate court should not interfere with that decision.

Conclusion

The emphasis on the fact-specific nature of the attribution principle means that *Singularis* will only be authority where the sole shareholder and director has perpetrated a fraud on the company in similar circumstances. However, if the sole shareholder is not the sole director, the decision does confirm that the high test of the complicity of the other directors will have to be met before attribution applies and even then the public policy behind the illegality defence may prevent its application.