Anderson & others v Sense Network [2018] EWHC 2834 (Comm), Jacobs J.

1. This case considers a number of interesting questions relating to liabilities of Networks for fraud committed by their Appointed Representatives. The judgment largely deals with established principles, but it is instructive to note how these principles were applied on the facts. The judgment is lengthy and complicated and this note is intended simply to draw attention to the points covered, some of which frequently arise in this class of claim.

2. Simon Howarth of Hailsham appeared for the successful Defendants, instructed by RPC LLP.

The Facts

3. The action arose from the fraudulent activities of a Mr Greig (G). G was the moving spirit behind a financial services firm (M), which was in turn an Appointed Representative (AR) of the Defendant.

4. G, and advisers employed by M, persuaded individuals to deposit monies in a bank account he controlled, on the basis that very high rates of return would be achieved. The scheme was a Ponzi fraud. It collapsed in 2014 following a whistle blowing disclosure to D which immediately informed the FCA and the police.

5. The offering was simple. The depositors were told that G had access, by virtue of his connections, to a high interest account with RBS. They were persuaded to deposit capital with him, allegedly for placement within this account, and promised returns far in excess of bank base rate. On "maturity" G generally persuaded them to "roll over" the investment for a further period, so that the returns existed "on paper", but were not actually paid out. This gave rise to the Ponzi structure.

6. The documentation was sparse – a simple acknowledgement letter, sent after the monies were paid over, and written on M's standard letterhead. That letterhead had a footer containing the standard regulatory status disclosure to the effect that M was an AR of D.

7. To meet its supervisory responsibilities, D operated a sophisticated and cloud based documentation system, requiring all documentation generated in relation to authorised business to be uploaded. D was thus able to carry out file reviews remotely. No

documentation making any reference to the scheme was uploaded to this system. D's control systems also included bank reconciliations to check that all monies received by M related to authorised business; this control was evaded by the use, in operating the Scheme, of a separate bank account (not in M's name but in a similar name), the existence of which was not declared to D.

8. The Court found that the scheme had been deliberately and systematically concealed from D by personnel at M, including a Mr Keith Ingram (KI), who had certain compliance responsibilities which D's compliance regime relied on him to discharge.

9. The Claimants' claim involved several distinct routes whereby it was sought to fix D with liability. These were:

   (a) A claim under section 39 FSMA 2000. For this claim to succeed it had to be established that D had given permission for M to carry out the Scheme. In considering this claim, the Court had to decide whether the Scheme was an Unregulated Collective Investment Scheme ("UCIS") within the definition given in FSMA (section 235);
   (b) A claim that M had actual or ostensible authority to promote the Scheme as D's agent;
   (c) A claim that D was vicariously liable at common law for the acts of M;
   (d) A claim that D was fixed with the knowledge of the Scheme possessed by an employee of M who carried out various compliance functions, as well as working as a paraplanner;
   (e) A claim based on alleged failure properly to supervise M;
   (f) A claim based on alleged failure properly to investigate certain incidents involving advisers at M. It was asserted that a proper investigation would have resulted in the termination of the agency agreement between M and D, and the cessation of the scheme.

<u>Section 39</u>

10. As to the section 39 argument, the Court held that this was not permitted business and hence was outwith the section. The Claimants' argument was that once a generic class of business was authorised the principal could not cut down the scope of the authorisation by placing restrictions on business within that class. D argued that it had not authorised the Scheme and that the only business it had authorised was business done through company agencies. The Court held that D was entitled so to restrict the authorisation, pointing out that section 39(1)(b) specifically contemplates authorisation being given for "part of" a generic class of

business. The Court relied on the commercial common sense of the restriction – the requirement to use a company agency permitted D to supervise the business done, because if it were done via a company agency D would be aware that it had been transacted. The Court also noted that the consequence of the Claimants' argument would be that the Scheme was authorised despite the fact that D had no regulatory permission to accept deposits and had specifically prohibited M from holding client money. Therefore, the section 39 argument failed at a threshold level.

UCIS

11. The Judge did consider, obiter, whether the Scheme was in fact a UCIS. He approached this question, in accordance with **FCA v Asset Land** [2016] UKSC 17, by looking at what was promised to the Claimants not what actually happened to the money. He held that the Scheme was a UCIS. He reached this conclusion despite the facts that (a) the returns were guaranteed and did not depend on the performance of the monies when entrusted to RBS, (b) what was promised to the Claimants was fixed interest, and (c) the "management" of the money consisted simply of placing it into the bank. He rejected the suggestion that "profits or income" from a UCIS connoted a degree of uncertainty as to the level of such profits or income. He concluded that guaranteed interest could be "profits or income" within the meaning of section 235, and that the money had been "managed" by G simply by operating the bank account. He also rejected a submission that the common account exception contained in paragraph 6 of SI 2001/1062 applied.

Agency

12. The Court rejected the argument that actual authority had been conferred, for essentially the reasons given on the section 39 issue.

13. The Court declined to hold that the "status disclosure" wording on the letter head gave rise to ostensible authority, for a number of reasons. Some Claimants abandoned their case in this respect as a result of admissions on their part in evidence which were fatal to any claim of reliance on ostensible authority. Other Claimants failed because they had signed documentation acknowledging that M had no authority to hold client money.

14. The Court held that the "status disclosure" was not a sufficient representation to found the ostensible authority argument because it was not a representation to the effect that there was authority to advise about the scheme. The Judge considered and explained well known authority including **Martin v Britannia Life** [2000] Ll Rep PN 412.

15. The Court also relied on the fact that, if the Claimants were right, a principal would be liable for any communication written on approved letterhead, and section 39 FSMA would be redundant. The Judge commented that this would be a surprising conclusion because it would "eviscerate the requirement" under section 39 for the principal to have authorised the business.

Attribution of the Knowledge of Mr Ingram

16. The Judge considered recent authority including **Bilta v Nazir** [2015] UKSC 23. He held that the correct approach was that this was a "category 3" case where attribution depended on fashioning a rule having regard to the context and the particular substantive rules in play.

17. He rejected a suggestion that KI, because of his compliance responsibilities, was a person authorised by the Defendant to "receive notifications" as discussed in **Al Ajou v Dollar** [1994] 2 AER 685.

18. On the facts, he rejected the argument for attribution. He pointed out that KI was an employee of M, and his compliance activities were directed towards achieving M's compliance responsibilities (as set out in the AR Agreement). He then pointed out that the SUP rules place responsibilities on the principal, requiring it to satisfy itself of certain matters on reasonable grounds. Thus, if proper controls had been operated by a principal it would be wrong to reach a conclusion that the principal might still be in breach of the rules because of the knowledge of an employee of the AR about certain matters, notwithstanding that the firm had exercised reasonable care. This was particularly the case given that breach of the SUP rules might lead to a fine or public censure.

19. The Judge concluded by considering the question (derived from authority including **Bilta**) whether "attribution is required to promote the policy of the substantive rule or… whether, if attribution is denied, that policy is frustrated."

20. He answered that question by noting that the policy of the rule was promoted by the fact that the principal of an AR has supervisory responsibilities and can be liable if it fails to discharge them. Indeed, the Claimants alleged such liability. The obligations of D in this respect sufficiently promoted the policy and there was no need to attribute the relevant knowledge.

Vicarious Liability

21. The Judge followed the Court of Appeal in **Frederick v Positive Solutions** [2018] EWCA Civ 431, in assuming that the relevant approach derived from **Cox v Ministry of Justice** [2016] AC 10, despite being attracted to the converse view.

22. He held that there was no vicarious liability on a **Cox** approach, because the Scheme was not an integral part of the business of D but was, rather, part of the recognisable and independent business of M. The Scheme was not an activity assigned by D to M, nor could it be said that D had created the risk of the Scheme being operated (not least because it had been in operation for some years before M became an AR of the Defendant).

Failure of Supervision

23. This claim failed on the facts and the expert evidence, both as to breach and causation (it was held that the extensive efforts to conceal the scheme would have been effective even if D had taken further steps). It is right to note that the Judge attached weight to the opinion of D's expert that their supervisory systems were "in the top 10 to 20%" across the industry.

Particular Incidents

24. Again the claim failed on the facts relating to the alleged breaches. It also failed on causation – the Judge accepted that any termination of particular advisers or M itself would not have prevented the Scheme continuing in operation, because, like all Ponzi fraudsters G could not afford for it to cease. The Judge accepted that the evidence taken overall showed that determined efforts would have been made to continue the Scheme.

Case note by Hailsham Chambers

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