Dishonest professionals:

Recent developments in the content of dishonesty, proving dishonesty and claims alleging dishonesty

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Section 1: Defining dishonesty

What is dishonesty?

1. The Supreme Court decision of Ivey v Genting [2017] UKSC 67 in which it reformulated the test for dishonesty has now been applied many times (and has also now been confirmed in the criminal context: R v Barton [2020] EWCA Crim 575). As a reminder, there are two-limbs. The fact-finding tribunal must ascertain:

    1.1. the defendant's actual state of knowledge or belief as to the facts; and

    1.2. whether, in the light of that state of mind, their conduct was honest or dishonest applying the objective standards of ordinary decent people.

2. The knowledge required as part of the first stage includes blind eye knowledge: Group Seven Ltd v Nasir [2019] EWCA Civ 614; [2019] 3 WLR 1011. Blind eye knowledge requires two conditions to be satisfied:

    2.1. the existence of a firmly grounded suspicion, which is targeted on specific facts that may exist. Untargeted or speculative suspicion is not enough;

    2.2. a conscious decision to refrain from taking any step to confirm the existence of those facts.[1]

3. However, more generalised suspicions falling short of 'blind-eye' knowledge may be taken into account when the fact-finding tribunal is making findings about the defendant's state of mind; and then coming to consider whether that knowledge is objectively dishonest.[2]

4. The question of how much is required to establish blind eye knowledge continues to provide a fertile ground for dispute. A recent case of interest is: Natwest Markets Plc v Bilta (UK) Ltd (In Liquidation) [2021] EWCA Civ 680.

    4.1. This was a claim brought by insolvent companies against a bank and its subsidiary for dishonest assistance and knowing participation in fraudulent trading, via the actions of its traders. The fraud in question was a form of VAT carousel fraud using

1 Stated at [59] and [60] in reliance on the dicta in the House of Lords in Manifest Shipping & Co Ltd v Unipolaris Insurance Co Ltd (The Star Sea) [2003] 1 AC 469. Permission to appeal was sought from Supreme Court in Group Seven, but was refused on the basis that 'in light of the Supreme Court's recent case law' (one assumes Ivey v Genting), the appeal raised no arguable point of law.

2 Ibid at [61]

carbon credit trades. Cs argued that the traders had acted dishonestly because they participated in transactions which facilitated the wrongdoing or that they had turned a blind eye to the fraud. The judge at first instance (Snowden J) agreed the Bank's traders were dishonest, though only for a certain period of time. The Bank appealed and argued successfully that the Judge failed to take into account key facts in relation to the alleged dishonesty. The case was remitted for a retrial.

4.2. However, an interesting point was raised on C's cross appeal that the judge should have found the dishonest assistance occurred over a longer period of time. C argued that all that it was necessary for them to prove to establish dishonesty, was that one of the traders had "questions and concerns" about the trading which he knew or believed he ought to have brought it to the attention of the bank's Compliance department. It was said that it if a trader has a degree of doubt about the legitimacy of the trading that he (the trader) says would lead him to go to Compliance, and he fails to do so, he is necessarily dishonest (see [129]).

4.3. The CA, in obiter comments, rejected that as "*an unwarranted dilution of the correct legal test*", and that the submission fell into error because it attempted to elevate mere suspicion into knowledge. Group Seven should not be taken out of context: [133]:

> *"The case goes no further than confirming that the honesty of a person's conduct falls to be considered objectively in the light of all relevant material including their state of mind. The court [in Group Seven] went on to find that, on the basis of the trial judge's findings as to the state of the defendant's actual knowledge of the relevant facts, the inescapable conclusion was that he had blind-eye knowledge that the recipient was not beneficially entitled to the money [96]–[101]. The defendant's whole course of conduct was objectively dishonest, because no reasonable and honest person who knew those facts would have done what he did to facilitate the payment. The case was therefore one of actual knowledge of facts which, objectively assessed, constituted a breach of trust."*

5. The judgment suggests the Courts are trying to preserve a sharp distinction between mere suspicion and belief when it comes to blind eye knowledge.

What is not dishonesty?

6. Unconscionability: hence the distinction between dishonesty and the knowledge required to establish the liability of a knowing recipient of trust property: Bank of Credit and Commerce International (Overseas) Ltd v Akindele [2001] Ch 437 at 448.

7. Recklessness: the classic statement is that of Lord Nicholls in Royal Brunei Airlines v Tan [1995] 2 AC 378 at 389-390: "*Imprudence is not dishonesty, although imprudence may be carried recklessly to lengths which call into question the honesty of the person making the decision. This is especially so if the transaction serves another purpose in which that person has an interest of his own*".... "*Acting in reckless disregard of others' rights or possible rights can be a tell-tale sign of dishonesty*".[3]

8. Gross negligence.

9. Whether gross negligence could suffice was recently tested in Stanford International Bank v HSBC Bank plc [2021] EWCA Civ 535. This is an important decision for claimants alleging

3 Affirmed in Clydesdale Bank Plc v John Workman [2016] EWCA Civ 73 at [48].

dishonesty against large companies who are faced with the challenge of pinpointing dishonesty when the company's acts are carried out by a large number of people.

10. The claim was set against the background of the collapse of SIB, an Antiguan-based investment bank set up and run by Allen Stanford. It was a massive Ponzi scheme which collapsed in 2009 in the way that Ponzi schemes tend to do.

11. SIB, by its liquidators, made two claims against HSBC: the relevant one for our purposes was a claim for an account or equitable compensation in respect of HSBC's alleged dishonest and/or reckless assistance in Mr Stanford's breaches of trust and fiduciary duty.

12. There was little dispute that Mr Stanford owed fiduciary duties to SIB and that every payment out of SIB amounted to a breach of that duty. Nor was there any serious dispute that HSBC had assisted Mr Stanford: the assistance rendered was that "HSBC continued to allow SIB to operate its bank accounts." However, HSBC contended the dishonest assistance claim should be struck out because there was no sufficient pleading of dishonesty.

13. SIB's argument was that HSBC was dishonest because it "*neither knew nor cared, and thereby turned a blind eye to whether SIB was being run dishonestly.*"[4] SIB argued that recklessness could amount to dishonesty in reliance on the statement of Lord Herschell in Derry v Peek (1889) 14 App Cas 337 where Lord Herschell explained the meaning of 'fraud' in the context of a claim for deceit as being where a fraudulent misrepresentation is made (1) knowingly (2) without belief in its truth or (3) recklessly, careless whether it be true or false.

14. SIB sought to argue that there was corporate recklessness which fell under the second and third categories. HSBC did not know or care whether SIB was being run properly or not. It ignored its own policies. It had developed an ingrained culture of failing to obtain knowledge.

15. The CA disagreed. It held that it was not appropriate to stretch Lord Hershell's words into a generalised claim that if one does not know or care about something one is dishonest in relation to it. "*Simply being very bad at what you should be doing is not dishonesty.*" (at [62] per Sir Geoffrey Vos, MR). Further, blind eye knowledge required targeted suspicion: per Group Seven. The suspicion has to be firmly grounded and targeted on specific facts – and there had to be a deliberate decision to avoid obtaining confirmation of those facts in whose existence the defendant had good reason to believe. Those things were not pleaded by SIB.

16. SIB also sought, in reliance on Sofer v Swiss Independent Trustees SA [2020] EWCA Civ 699, to argue that the collective knowledge of HSBC's employees had to be taken into account. But the CA rejected that approach and said it is not possible to point to two people who know something and two other people who know something else and put them together and say if the same knowledge were held by the same person there would be dishonesty.

17. The decision confirms there is no special (less demanding) test for dishonesty when it comes to large companies: claimants in such cases may simply face a greater challenge in identifying the dishonesty of particular employees.

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4 At [18]

Section 2: Proving dishonesty

Standard of proof

18. We think we all know that the civil standard of proof applies. But statements of principle abound which have tended to suggest a higher standard in cases where fraud is alleged. For example:

    18.1. fraud has to be regarded as less likely than honesty: Fiona Trust & Holding Corporation v Privalov [2010] EWHC 3199 (Comm) at [1438]-[1439].

    18.2. The more serious the allegation, the more cogent the evidence that will be required to prove it, because of the inherent improbability that a person will risk the serious consequences that proof of the allegation could entail: Fiona Trust at [1438].

    18.3. In some cases, the inherent improbability of the allegation can be such that the civil standard is akin to the criminal standard of proof beyond reasonable doubt, although that is not invariably so: Fiona Trust at [1439].

    18.4. It is not possible to infer dishonesty from facts that are equally consistent with honesty. There must be some fact "which tilts the balance and justifies an inference of dishonesty" – per HHJ Flaux in JSC Bank of Moscow v Kekhman [2015] EWHC 3073 (Comm) at [20] referring to Lord Millet's judgment in Three Rivers District Council v Bank of England [2001] UKHL 16; [2003] 2 AC 1.

19. However, in Bank St Petersburg PJSC and another v Arkhangelsky and another [2020] EWCA Civ 408, Court of Appeal said clearly that there was a single standard of proof in civil proceedings: the balance of probabilities. The Court confirmed the test was as set out by Lady Hale in In re B (Children) [2008] UKHL 35, [2009] 1 AC 11:

    "70. My Lords, for that reason I would go further and announce loud and clear that the standard of proof in finding the facts necessary to establish the threshold under section 31(2) or the welfare considerations in section 1 of the 1989 Act is the simple balance of probabilities, neither more nor less. Neither the seriousness of the allegation nor the seriousness of the consequences should make any difference to the standard of proof to be applied in determining the facts. The inherent probabilities are simply something to be taken into account, where relevant, in deciding where the truth lies. ..."

20. In so holding, the Court found the lower Court had failed to apply the correct standard, and held the lower judge had fallen into error when he stated (by way of example):

    20.1. the "burden of proof...could only be discharged by showing the facts to be incapable of innocent explanation".

    20.2. What was necessary for him to decide was whether Cs justification of certain facts "was a plausible one".

    20.3. "The more benign interpretation can only be dislodged by evidence of sufficient strength to oust it in favour of a more malign one."

21. The judgment confirms that the correct standard is neither more nor less than the balance of probabilities. The question will be whether in each case the dishonesty was more probable than not. It is still true that fraud and dishonesty require cogent proof, because it is still inherently unlikely that people will do dishonest things. But that improbability is not invariably true, and account must be taken of the context.

Summary determination of claims involving allegations of dishonesty

22. It is generally very difficult for a claimant to obtain summary judgment in a case which involves an allegation of fraud. Some reasons for that were given by Mummery LJ in Doncaster Pharmaceuticals Group Ltd v The Bolton Pharmaceutical Company 100 Ltd [2006] EWCA Civ 661:

    22.1. [5] ....The decision-maker at trial will usually have a better grasp of the case as a whole, because of the added benefits of hearing the evidence tested, of receiving more developed submissions and of having more time in which to digest and reflect on the materials....

    22.2. [17] It is well settled by the authorities that the Court should exercise caution in granting summary judgment in certain kinds of case. The classic instance is where there are conflicts of fact on relevant issues, which have to be resolved before a judgment can be given ... A mini-trial on the facts conducted under CPR Part 24 without having gone through normal pre-trial procedures must be avoided, as it runs a real risk of producing summary injustice.

    22.3. [18] In my judgment, the Court should also hesitate about making a final decision without a trial where, even though there is no obvious conflict of fact at the time of the application, reasonable grounds exist for believing that a fuller investigation into the facts of the case would add to or alter the evidence available to a trial judge and so affect the outcome of the case."

23. Moreover, the test on summary judgment is of course more demanding than proof on the balance of probabilities: it is that the defendant has no real prospect of successfully defending the claim.

24. But a number of recent decisions suggest the Courts are more and more willing to grasp the nettle where the evidence of fraud is strong. For example:

    24.1. Foglia v Family Officer Ltd [2021] EWHC 650 (Comm)

    24.2. Global Metals AG & Another v Colony Capital Ltd & Others [2020] EWHC 3361 (QB)

    24.3. Burns v Burns [2021] EWHC 75 (Ch).

25. The key factors which persuaded the court to make a determination in these cases were generally (i) the availability of contemporaneous documentary evidence; (ii) the absence of any realistic alternative explanation from the defendant; (iii) the fact that the explanation of the defendant was inconsistent with the contemporaneous documentary evidence.

26. Other factors will also play a part: (i) whether it is likely that further evidence will be available at trial; (ii) whether any party has changed their case up to the hearing of the application; (iii) whether a defendant has given voluntary disclosure of evidence which is available to them and which is capable of rebutting the allegations.

27. However, there are cases which are not allowed even to proceed to disclosure. In Maranello Rosso Ltd v Lohomij BV & Ors [2021] EWHC 2452 (Ch), HHJ Keyser QC struck out the majority of a claim for unlawful means conspiracy, in part, as he found that it had previously been compromised but in part on the merits (prior to disclosure being given). Here the Court was prepared to make findings about the likelihood of the Claimant's case being accepted at trial and was unwilling to accept the factual evidence advanced by the Claimant on its face.

28. Do these cases suggest a greater willingness on the part of the Courts to deal with fraud claims on the merits?

Section 3: What causes of action can be unlocked by a plea of dishonesty? How can they be defended against? Recent developments.

Possible causes of action:

29. Fraudulent misrepresentation

30. Deceit

31. Economic torts: conspiracy / procuring a breach of contract

32. Dishonest breach of fiduciary duty

33. Knowing receipt / dishonest assistance

34. Wrongful or fraudulent trading

35. Unlawful means conspiracy

Remedies

36. Sometimes, the choice of which remedy to pursue will depend on what remedies the cause of action gives rise to. Consider the following:

    36.1. Rescission of contract: for misrepresentation

    36.2. Repayment of money, i.e. restitution

    36.3. Recovery of assets – proprietary remedies

    36.4. Damages

Potential defences

37. Exemption clauses – trustees (also statutory defence under s.61 Trustee Act 1925)

38. Limitation (although beware s.32 of the Limitation Act 1980)

39. Justification? Available for conspiracy to injure but not unlawful means conspiracy: Palmer Birch v. Lloyd [2018] EWHC 2316 (TCC); [2018] 4 W.L.R. 164, at 192-193.

40. In disciplinary proceedings in the SDT, 'exceptional circumstances' sometimes justify a lesser sanction than the usual sanction of strike-off for dishonesty, and there have been a number of recent decisions where such exceptional circumstances were found.[5]

Some notable developments

41. Bribery and secret commissions: Wood v Commercial First Business ltd and Business Mortgage Finance 5 Plc v Pengelly [2021] EWCA Civ 471:

    41.1. Elements of the cause of action: (i) Agency (typically fiduciary) relationship, (ii) a benefit received by the recipient; (iii) secrecy, (iv) the briber must know the recipient was acting as an agent.[6]

    41.2. For (i), does the relationship have to be fiduciary in nature? David Richards L.J. (with whom Males and Elisabeth Laing L.JJ. agreed) held there was no such requirement. Instead, the question was whether the payee was under a duty to provide information, advice or recommendations on an impartial or disinterested basis. If the payee was under such a duty, the payment of bribes or secret commissions would attract civil remedies: [92], [102], [110].

    41.3. Does the case go further? There were obiter comments that the recipient of the bribe need not even be an agent of the innocent party – they only needed to be "*someone with a role in the decision-making process in relation to the transaction in question...namely in a position to influence or affect the decision taken by the principal.*" (at [51], quoting Christopher Clarke J in Novoship (UK) Ltd v Mikhaylyuk [2012] EWHC 3586 (Comm) at [108]).

    41.4. The case is potentially problematic: if a person is an agent, he will invariably owe fiduciary duties. If he is not an agent, then why should the rules of agency (including rules which allow for rescission for bribery) apply? Does this open up the remedy of rescission to a wider category of claims?

42. Misrepresentation:

    42.1. Elements of the cause of action: (i) a false statement of fact (or in some cases, of opinion); (ii) which the representor intends the representee to rely on; (iii) which is relied upon (iv) causing loss.

    42.2. The need for reliance was subjected to scrutiny in Leeds City Council v Barclays Bank Plc [2021] EWHC 363 (Comm) – a decision of Cockerill J in February last

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5 See, for example: Solicitors Regulation Authority v Orton (4 January 2021); Solicitors Regulation Authority v Panesar-Jagdev (heard on 8 December 2020); Solicitors Regulation Authority v McCullagh (28 January 2021).
6 See generally Petrotrade Inc v Smith (Vicarious Liability) [2000] 1 Lloyd's Rep. 486 and Ross River Ltd v Cambridge City Football Club Ltd [2007] EWHC 2115 (Ch).

year. Claims were brought by various Councils who had taken substantial loans from Barclays, the interest rate and other features of which were referable to the LIBOR rate. Barclays had of course been found to have manipulated LIBOR in around 2012. The Councils brought claims for the rescission of the loans on the basis that they had been fraudulently induced to enter them: Barclays had impliedly represented that LIBOR was honestly set and was not being manipulated.

42.3. Barclays applied to strike out the action, inter alia, because the Councils could not establish reliance. The Bank argued that it was necessary to show the Councils were aware of the representation. The Councils disagreed, and the focus of argument was whether – especially in cases where the representation was said to have been implied or by implied by conduct – it was necessary for the representee to show that it had given some "active" or "contemporaneous conscious thought" to the representation. The Councils said no – it is sufficient as a matter of law that a representee assumes the matters which were represented by conduct.

42.4. Cockerill J held that:

f"or a misrepresentation to be actionable, the representee must be aware of it – he must understand it in the sense in which he later complains of it; it must be "actively present to his mind"".[7]

42.5. Further, there is a difference between making an assumption about something and being aware of it (in the sense of it being actively-present in the representee's mind). The Judge gave an example at [113]:

"The waiter, in deciding to convey the order to the kitchen, has done so because he has actively, albeit almost automatically, processed the question " is this customer good for the money? ". It is not, of course, unheard of for someone in the waiter's position to refuse to serve a customer if quasi-automatic consideration of the representation produces a negative answer to this question."

and the Judge added a footnote to say*:*

"See for example the famous Rodeo Drive shopping scene in the movie "Pretty Woman": "I don't think we have anything for you. You are obviously in the wrong place."

42.6. The Judge ultimately found in favour of Barclays. The Councils had not established that they were aware of and had understood the implied representation alleged.

43. The judgment sets a marker for the test for inducement/reliance in claims where implied representations are alleged (and not merely where the cause of action is fraudulent misrepresentation, although the Judge did comment that where fraudulent misrepresentation was alleged, the court should not be too ready to accept that a claimant was induced by an assumption as opposed to a representation (at [67])).

44. It may also inform the requirement for reliance in claims under s.90 FSMA, under which an issuer of securities is liable to pay compensation to a person who has acquired, held or disposed of securities in reliance on certain publications to the market and suffered loss as a

7 [102], approving the judgment of Picken J in Marme Inversiones 2007 v Natwest Markets plc [2019] EWHC 366 (Comm).

result of any untrue or misleading statements. There have been a number of recent s.90 cases[8], which has otherwise been a remarkably under-utilised weapon for investors. But note the decision on the first s.90 claim ever to reach trial was handed down on 23 February 2022 in summary form – this was a decision on the well-known USD$5bn civil fraud action concerning Hewlett Packard's acquisition of UK software company Autonomy in 2020. The judgment is yet to be handed down and it will be interesting to see whether we see more s.90 cases to follow.

Section 4: Pros and cons of alleging fraud and practical suggestions about handling claims

45. Whether to plead and advance claims in fraud, especially against a professional, is often a tactically difficult decision. This section deals, in summary form, with some of the advantages and disadvantages of alleging fraud.

Advantages of alleging fraud

45.1. The key advantage in alleging fraud lies in the extent and flexibility of the causes of action (as we identify above). Wherever dishonesty causing loss can be established, there us likely to be a cause of action (such as economic torts, equitable claims, unjust enrichment or other common law remedies). Further the Courts are prepared to develop the causes of action to address specific issues.

45.2. There may also be personal claims against individual (such as directors) which would not be available in a claim in negligence.

45.3. Protective injunctive relief is also more likely to be available where there are allegations of dishonesty. Whilst there needs to be evidence of a risk of dissipation to obtain freezing relief, this is more easily inferred if coupled with prima facie evidence of fraud – see, for example, PJSC Tatneft v Boglyubov [2016] EWHC Comm 2816.

45.4. The applicable rules of causation and loss may also be preferable. In particular:

45.4.1. There is no need to demonstrate foreseeability (Nationwide Building Society v Dunlop Haywards (DHL) Ltd [2010] 1 WLR 258);

45.4.2. The is no need to demonstrate that the loss falls within the scope of the professional's duty;

45.4.3. Contributory negligence does not apply (absent fraud by the claimant and even then not in equitable cases) - Nationwide Building Society v Balmer Radmore [1999] PNLR 606.

45.4.4. Compound interest is generally available.

[8] For example: Allianz Global Investors GmbH & Ors. v RSA Insurance Group Limited [2021] EWHC 2950 (Ch) (limitation decision)); Various Claimants v G4S plc [2021] EWHC 524 (Ch) (claims struck out for failure to comply with joinder rules)

45.5. The limitation period may be longer (as time does not start running until the fraud has been discovered – section 32 of the Limitation Act 1980). There is no limitation period of fraudulent breaches of trust – section 21 of the Act.

45.6. A final advantage is that claims in fraud may not be excluded by compromise agreements. Whether such claims are compromised is a matter of construction of the release. However, as a general rule, clear words will be needed to exclude a claim in fraud which was unknown to the parties (BCCI v Aliv [2001] UKHL 8, [2002] 1 AC 251). Even if the construction of the clause is sufficiently wide so as to exclude claims in fraud, it may be possible to take advantage of the sharp practice exception – which derives from BCCI v Aliv. An attempt to do this failed in Maranello Rosso Ltd v Lohomij BV & Ors [2021] EWHC 2452 (Ch), although permission to appeal has been granted.

Disadvantages

46. There are, however, distinct disadvantages to pleading fraud.

46.1. The primary issue is that whilst the standard of proof is the same (as outlined above), claims in fraud will be more difficult and expensive to bring and prove. Mere negligence will not suffice; dishonesty must be proved.

46.2. Further, if the allegations are proved in a claim against a professional, this is likely to have regulatory consequences for the professional. Necessarily, this significantly raises the stakes of any litigation, further increasing costs and decreasing the prospects of settlement (in many cases).

46.3. The other costs consequence is that not only will the costs be higher, if the allegations fail, an order of indemnity costs is likely. The rationale is simple: if you prove dishonesty, the dishonest defendant will be liable to pay costs on the indemnity basis; if the allegations were wrongly made, the party asserting the claim pays on the indemnity basis.

46.4. Perhaps the most significant disadvantage in a claim involving a professional relates to coverage. No professional indemnity policy will provide cover in the event that the insured's liability arises from his or her own fraud – such cover is excluded as a matter of public policy. As a result, almost all professional indemnity policies exclude dishonesty. This may not be the end of the matter as innocent partners (or the corporate entity) may still have the benefit of insurance but this is fact-dependent. The fact that there may be a coverage issue if the claim succeeds is a further disincentive to settlement.

46.5. Making allegations of fraud may also increase the prospects of claims being aggregated. If there is a fraud involving a number of different transactions, this is likely to be found to be a series of related transactions (the relevant wording in the SRA Minimum Terms). In AIG Europe Limited v Woodman [2017] 1 WLR 1168, the Supreme Court warned against taking too restrictive a view as to what amounts to be related and it is possible that multiple victims of fraud will only have the

benefit of limited (aggregated) cover under the policy.[9] The same may not be true of unrelated negligent acts in various transactions.

The bottom line

47. It is therefore critical in a claim against a professional to consider whether allegations of fraud should be made and, if so, how they should be framed. When pleading the claim, the potential insurance ramifications need to be considered carefully.

[9] But cf Baines v Dixon, Coles & Gill (a firm) [2021] EWCA Civ 1211, where the Court of Appeal considered sub-clause 2.5(a)(ii) of the SRA Minimum Terms and found on the facts that a partner's repeated misappropriation of funds from client trusts and estates administered by the firm were not a "series of related acts" and so the claims did not fall to be aggregated.