ANDERSON v SENSE NETWORK

CASE NOTE

Simon Howarth and Alex Echlin of Hailsham Chambers successfully resisted the Claimants' appeal in **Anderson v Sense Network** [2019] EWCA Civ 1395. This decision breaks new ground in relation to 2 key sections of FSMA 2000 but leaves an important question as to vicarious liability at common law unanswered.

The Action and the Appeal

1. The claims arose out of the Claimants' participation in a Ponzi scheme, masterminded by a Mr Greig, the principal of an Appointed Representative of Sense. The scheme had been run by Mr Greig for some years prior to his IFA firm becoming an AR of Sense.

2. In the court below, it was asserted that Sense ought to have detected and prevented the operation of the scheme, but this case failed. Various other routes to liability were asserted and rejected. In particular, there was no question of the AR having ostensible authority to run the scheme, because the arrangements were entirely oral. The only documents issued were acknowledgement letters, produced after monies were placed in the scheme, and thus incapable of giving rise to ostensible authority because they were not relied on prior to the investment being made.

3. There were 3 issues in the Court of Appeal:
    a. Was the scheme an unregulated collective investment scheme (UCIS)?
    b. Was Sense entitled to limit the permission it gave to its AR by a requirement that business be done exclusively through company agencies, such that it was not liable under s.39 FSMA?
    c. Was Sense vicariously liable at common law for the activities of the AR?

Issue (a): UCIS or not?

4. The starting point is to ascertain what investors were told about how the scheme would operate. This is because one looks to the "arrangements" as described to the investor, not at what was in fact done, nor at any formal contract later entered into (**Asset Land v FCA** [2016] UKSC 17 followed).

5. The arrangements described to depositors in connection with the scheme were simple. Mr Greig said that he had access to a high interest account with RBS. If depositors entrusted him with their money, it would all go into this account and they would receive a (very high) guaranteed return on a specific date. Mr Greig said that RBS was able to afford these high returns because of what it proposed to do with the money when received; various explanations were given.

6. Of course, these explanations were bogus. Mr Greig was siphoning off funds for his own benefit, whilst repaying any investor who sought return of his funds from new deposits made by other victims. Repayments were kept relatively low by encouraging depositors to "roll over" their investment so that money was not returned to them and their "profits" were on paper only.

7. The Court of Appeal held that the scheme was a UCIS. It rejected Sense's case that the following features were incompatible with that conclusion:
    a. The fact that the returns promised were guaranteed. The Court held that it was not inherent in the nature of a UCIS that the "profits or income" payable to participants should be uncertain in fact or amount [73];
    b. The fact that all that Mr Greig was doing was depositing cheques and making some repayments. The Court agreed with the judge that this still amounted to "management" of the money, observing that management need not be onerous nor require any particular skill [78];
    c. The fact that all monies were to be received into a single account meant that there was "pooling" even though that word was not used and investors were told that they had specific rights to specific sums [79];
    d. Lack of clarity in the evidence about the arrangements was due to the fact that the scheme was bogus [79].

8. The Court also held that the exemption for common accounts (reg 6 of SI 2001/1062) did not apply, essentially because the rights relating to the bank account were Midas's rights against RBS and not the rights of investors [81].

9. The decision therefore confirms that the definition of a UCIS is very wide and can include schemes which differ considerably from the usual activities such as the joint exploitation of farmland, or land banking.

Issue (b): Section 39

10. This is the first case in which the Court of Appeal has been called upon to construe section 39 FSMA (or its predecessor section, section 44 of the 1986 Act).

11. The Court was in no doubt that it was open to a Network to restrict the permission it gives to an Appointed Representative (and therefore its liability under section 39) to particular products. The Court observed that any other conclusion gave no proper effect to the facts that (i) the very source of appointed representative status is a written permission from the principal [33] and (ii) the section specifically permits a principal to authorise his AR to undertake "the whole or part" of a regulated activity [36]. The Appellants' argument simply failed to give effect to the "clear and unqualified" words of the section [37, 38].

12. The Court held [40] that there was a clear and intelligible distinction between restrictions in the AR Agreement as to what business could be done (which do affect the scope of s.39 liability) and provisions relating to how the business should be done (e.g., a provision requiring the AR to act in accordance with COBS).

13. The fact that a principal cannot escape liability under section 39 by showing that the manner in which the AR did business was in breach of the AR Agreement (see **Ovcharenko v Investuk** [2017] EWHC 2114 (QB)) does not mean that the principal cannot show that the business itself was not permitted by the agreement.

14. The Court also confirmed that **Martin v Brittania Life** [2000] Ll Rep PN 412 and **R v FOS (on the application of Tenetconnect)** [2018] BCLC 726 establish no more

than that, if an adviser gives advice on a transaction which has both regulated and unregulated business as constituent elements, the adviser and his principal are liable for the unregulated business if it is inherently bound up with the regulated element [47, 48].

15. The Court observed (at [57]) that a consequence of this conclusion was that principals would only be liable for business which they had permitted by the AR Agreement, which is consistent with the obligation of the principal to supervise such business. This commercially sensible conclusion will, it is thought, be welcomed by IFA Networks. Had the Court concluded otherwise, then Sense would have been liable despite the Judge's finding, below, that it was "a very good firm" in terms of its supervisory regime, and despite his finding that Sense was not at fault in failing to discover the scheme.

16. The Court held that some assistance was obtained from the Gower report into investor protection, the genesis of the statutory "vicarious liability" in the 1986 Act and FSMA. However, the Court held that this report, properly understood, assisted Sense because it showed that what is now section 39(3) was enacted to avoid any grey area as to whether the principal was vicariously liable at common law (see [39, 54]).

Issue (c): Vicarious Liability

17. The case alleging vicarious liability at common law was dismissed relatively shortly as having "no substance" [64]. The Judge below had found as a fact that, assuming that the relevant test was that set out in **Cox v Ministry of Justice** [2016] AC 660, Sense was not liable because the scheme was part of the business of Midas, not Sense. It could not be said that Sense had assigned the task of carrying out the scheme to Midas nor that the scheme was carried on for Sense's benefit. The appeal failed because it was essentially a challenge to findings of fact.

18. Thus, the Court did not need to consider Sense's arguments that **Cox** was not the correct place to begin, in a commercial agency case [65]. This case therefore leaves that issue open, in the same way as the Court did in **Frederick v Positive Solutions** [2018] EWCA Civ 431.

19. Important issues therefore remain for another day. These include:
    a. Is vicarious liability for fraud, or in cases involving dishonest conduct, or in reliance based torts generally, governed by a separate set of principles?
    b. Is there a simple means of reconciling the **Cox** principles with the traditional law of agency, by treating actual and ostensible authority as the tests, in an agency context, for answering the question whether the conduct complained of is an integral part of the principal's business?

20. It is submitted that the answer to both these questions is "yes".

21. As to question (a), there is a series of cases supporting the contention that vicarious liability for certain types of tort, common in the commercial agency context, is governed by distinct principles. These include **The Ocean Frost** [1986] 1 AC 717 at 780A-C per Lord Keith, **Credit Lyonnais v Export Credit Guarantee Dept** [2000] 1 AC 486 at 495C-D per Lord Woolf M.R. and **Dubai Aluminium v Salaam** [2003] 2 AC 366 at paragraph 39 per Lord Nicholls and paragraphs 100 and 114 per Lord Millett).

22. It is submitted that to seek to establish a test for vicarious liability which applies across the whole spectrum of the law, from sexual abuse through personal injury and to commercial agency cases as well, represents the wrong path for the law to take. A similar attempt to establish a single formula for the existence of a duty (**Anns v LB of Merton** [1978] AC 728) proved unworkable. It is suggested that the same would apply here.

23. As to question (b), it is submitted that **Cox** does not require us to rip up centuries of learning on agency law. It is clear that, if a principal gives actual authority to his agent to act in a particular way, the act is sufficiently connected to the principal's business for him to be vicariously liable. It is also clear that if the principal gives ostensible authority, such that he is estopped from denying the sufficiency of the connection (see **Freeman & Lockyear v Buckhurst** [1964] 2 QB 480), then there ought to be vicarious liability, provided that the claimant has relied on the holding out

of the agent. This is because the transaction has been entered into by the claimant on the faith of the necessary connection being established.

24. In this way, the traditional law can be seen to be consistent with the broad principle enunciated in **Cox**. It is submitted that this analysis is supported by the decision of the Court of Appeal in **Quinn v CC Automotive Group Ltd** [2010] EWCA Civ 1412, and by the analysis adopted in the cases cited at paragraph 21 above.

Conclusions

25. **Anderson** is a welcome decision for IFA Networks, in so far as it confirms the common industry understanding of section 39 FSMA.

26. Claimants will no doubt criticise the decision as striking against the objective of consumer protection. However:
    a. Had Sense been liable, it is not obvious that the general objective of consumer protection would have been enhanced. This is because the result would have been that a Network which had devised and operated a detailed and effective supervisory system would have been held liable notwithstanding the care it had taken, and notwithstanding that it had not discovered and could not have discovered the scheme. Such a decision would hardly incentivise other businesses to operate sophisticated systems. Instead it would encourage a culture in which the bare minimum necessary to satisfy the SUP rules would be carried out;
    b. It is notorious that IFAs and Networks find it difficult and expensive to obtain indemnity insurance (see the industry's response to the recent FCA consultation on raising the FOS compensation limit). It is not in the interests of consumers for IFAs and Networks to be unable to afford proper insurance. Self-evidently that would lead to judgments which cannot be enforced, but also to firms ceasing business, reducing consumer choice, and an expansion in the ranks of unregulated "introducers" and other entities who prey on naïve investors.

27. The Court has clarified the breadth of the definition of a UCIS. IFAs need to be astute to recognise the breadth of the definition.

SIMON HOWARTH
Hailsham Chambers
4 Paper Buildings
Temple
London EC4Y 7EX
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Simon Howarth, leading Alexander Echlin of Hailsham Chambers, appeared for the Respondent in the Court of Appeal and acted for Sense throughout the litigation.