[2015 Gib LR 209]

MARRACHE AND COMPANY, LAVARELLO and HYDE v. BAKER TILLY (GIBRALTAR) LIMITED

SUPREME COURT (Jack, J.): May 8th, 2015

Companies—auditors—professional negligence—solicitors' liquidators may sue auditor for breach of Solicitors' (Practising Certificates) Rules 2005, r.4—liquidators hold cause of action on trust for clients, as purpose of r.4 to protect clients from loss caused by solicitors' malpractice

Partnership—legal identity—relations between partners and partnership—wrongdoing by partners to be attributed to partnership because partnership has no separate legal identity—nothing more than relationship between partners

The claimants brought an action against the defendant for damages for negligence, conspiracy to defraud and dishonest assistance in breaches of fiduciary duty.

Three brothers, Isaac, Benjamin and Solomon Marrache, were convicted of conspiracy to defraud (the judgment on conviction is reported at 2013–14 Gib LR 540). Isaac and Benjamin were partners of the law firm Marrache & Co. The essence of the fraud was that they had stolen money from the Marrache & Co. client account.

As a result of the brothers' wrongdoing, Marrache & Co. and the brothers became insolvent. The firm was wound up and the claimants were appointed as its liquidators.

The defendant was a firm of chartered accountants which had prepared financial statements for Marrache & Co. from 1998 until 2008 and accountants' report forms, pursuant to r.4 of the Solicitors' (Practising Certificates) Rules 2005, from 2005 until 2008.

The claimants sued the defendant for damages, relying on three causes of action: (a) the defendant had negligently failed to identify and/or report the wrongful withdrawal of moneys from Marrache & Co.'s client account; (b) there was a conspiracy to defraud the firm through the withdrawal of very significant sums of money from its client account and the defendant was a party to that conspiracy; and (c) the Marrache brothers had breached fiduciary duties owed by them to the firm and the defendant had dishonestly assisted those breaches. The particular act relied on by the claimants was the defendant's failure, in drawing up the firm's financial statements and accountants' report forms, to highlight the withdrawal of large sums of money from the client account.

The defendant applied to strike out the claims. It submitted that the claimants stood in the shoes of the Marrache brothers, and if the brothers had sued the defendant, it would have had an absolute defence of *ex turpi causa non oritur actio* because the brothers would have had to rely on their own illegal behaviour to bring their claims. There were two steps in this argument: (a) any claim by the brothers would have been barred by *ex turpi causa*, and (b) their fraud would be attributed to Marrache & Co. and the claimants, as liquidators of the firm, could, *vis-à-vis* the defendant, have been in no better position than the firm and the brothers would have been.

The claimants submitted in reply that (a) since recent case law exhibited a number of different judicial views on the test for *ex turpi causa*, this was an area of difficult or developing jurisprudence making a strike out inappropriate; and (b) the brothers, as partners of Marrache & Co., owed fiduciary duties to the firm which the claimants as liquidators could enforce. The claimants relied on a principle of attribution whereby wrongdoing by a company's directors against the company could not be attributed to the company as a defence to a claim brought against the directors by the company's liquidator for loss suffered as a result of the wrongdoing. The claimants submitted, in the alternative, that they had a cause of action which should not be struck out based on r.4 of the Solicitors' (Practising Certificates) Rules 2005, in that the defendant failed to provide accountants' report forms which complied with r.4 and (a) there was a requirement for a cause of action to lie against an accountancy firm which breached r.4, and/or (b) *ex turpi causa* was a rule of public policy which should not prevail if there were a countervailing and stronger public policy argument and the importance of providing a cause of action to enforce r.4 was such an argument.

Held, dismissing the application:

(1) The claimants had an arguable case against the defendant based on the defendant's breach of the Solicitors' (Practising Certificates) Rules 2005, r.4 which would not be struck out. There were three possibilities in respect of a claim for breach of r.4: (a) individual clients of Marrache & Co. had a claim against the defendant; (b) the claimants had a claim; or (c) no one had a claim. (c) was problematic because it would mean that an auditor's failure to give an accountants' report form complying with r.4 would have no legal consequences. (a) was problematic because there might not have been a relationship of sufficient proximity between the defendant and the individual clients of Marrache & Co., particularly given that the defendant's last accountants' report form was for the year ending June 30th, 2008 and the fraud was not discovered until 2010, and it was very likely that the clients and the moneys held for them in 2010 were different from those held in 2008. By contrast, it was arguable that the claimants should be allowed to sue in respect of the defendant's failure to comply with r.4. The purpose of r.4 was to protect clients against losing money as a result of fraud by solicitors and allowing the claimants to sue

the defendant for breach of r.4 would ensure that this purpose was fulfilled. The claimants would hold this cause of action on trust for clients who had money in the client account in 2010. The claimants' action could therefore proceed to trial on the basis of the r.4 claim (paras. 35–36; para. 38; para. 42; para. 45).

(2) The precise test for the application of the *ex turpi causa* doctrine was an area of difficult or developing jurisprudence but this did not prevent the claim from being struck out because the precise test was irrelevant in the present case. On any view, the conspiracy to defraud committed by the Marrache brothers would have barred any claim by the brothers themselves against the defendant by virtue of the doctrine (para. 16).

(3) If a discretionary approach were taken to the application of *ex turpi causa*, the claimants could not argue that the court should exercise its discretion more favourably towards them than it would have towards the Marrache brothers. Such an argument would be wrong as a matter of principle because if, before the liquidation and bankruptcies began, the brothers had had no claim against the defendant, then a cause of action could not suddenly arise once the liquidation and bankruptcies began (para. 17).

(4) The principle of attribution relied on by the claimants did not apply because Marrache & Co. never had any legal personality separate from that of its partners. The wrongdoing of the Marrache brothers would therefore be attributed to Marrache & Co., the claimants stood in the shoes of the brothers, and the defendant could rely on the *ex turpi causa* doctrine against the claimants. It was true that the assets of a partnership should be treated differently from the assets of the individual partners but the position of a partnership was still different from that of a limited company. If a limited company became insolvent, its directors would be under a duty to take steps to protect its creditors, and its liquidators could sue the directors for breach of that duty. No such duty would apply if an individual became insolvent. If a partnership became insolvent, its assets would be held on trust for its creditors and the partners would be obliged to petition for its winding up as an unregistered company, but this did not assist the claimants because it gave no separate entity any free-standing right to enforce the trust for the benefit of the creditors. The partnership was never anything more than a relationship between the partners and it was not possible to separate the firm from the partners (paras. 26–29; para. 32).

(5) The principle of attribution relied on by the claimants also could not apply because a key element of that principle was the existence of an innocent company which had been wronged by the actions of its directors. This was not the case here: the Marrache brothers' wrongdoing was not directed against the firm and it was not wronged by their actions (para. 31).

(6) However, it was arguable that the application of the *ex turpi causa* defence was outweighed by the public interest in ensuring a meaningful remedy against auditors for breach of their r.4 duties, and the claims would not therefore be struck out. This would mean that, before the insolvency proceedings began, Marrache & Co. would have had a claim against the defendant, but this would not be an insuperable problem because it would have held the claim against the defendant on trust for its clients (paras. 50–51).

Cases cited:

(1) BGHZ 146, 341, Bundesgerichtshof, January 29th, 2001 (Neue Juristische Wochenschrift 2001, at 1056), referred to.
(2) *Cross* v. *Kirkby*, *The Times*, April 5th, 2000, referred to.
(3) *Euro-Diam Ltd.* v. *Bathurst*, [1990] 1 Q.B. 1; [1988] 2 W.L.R. 517; [1988] 2 All E.R. 23; [1988] 1 Lloyd's Rep. 228, referred to.
(4) *Hampshire Land Co. (No. 2), In re*, [1896] 2 Ch. 743, distinguished.
(5) *Holman* v. *Johnson* (1775), 1 Cowp. 341; 98 E.R. 1120, referred to.
(6) *Hounga* v. *Allen*, [2014] 1 W.L.R. 2889; [2014] 4 All E.R. 595; [2014] I.C.R. 847; [2014] I.R.L.R. 811; [2014] H.R.L.R. 23; [2014] UKSC 47, considered.
(7) *Jetivia S.A.* v. *Bilta (UK) Ltd. (In Liquidation)*, [2016] A.C. 1; [2015] 2 W.L.R. 1168; [2015] 2 All E.R. 1083; [2015] 2 Lloyd's Rep. 61; [2015] BCC 343; [2015] 1 BCLC 443; [2015] B.V.C. 20; [2015] UKSC 23, considered.
(8) *Law Society* v. *KPMG Peat Marwick*, [2000] 1 W.L.R. 1921; [2000] 4 All E.R. 540; [2000] Lloyd's Rep. P.N. 929; [2000] P.N.L.R. 831, considered.
(9) *Les Laboratoires Servier* v. *Apotex Inc.*, [2015] A.C. 430; [2014] 3 W.L.R. 1257; [2015] 1 All E.R. 671; [2014] Bus. L.R. 1217; [2015] R.P.C. 10; [2014] UKSC 55, referred to.
(10) *Morgan Crucible Co. plc* v. *Hill Samuel & Co. Ltd.*, [1991] Ch. 295; [1991] 2 W.L.R. 655; [1991] 1 All E.R. 148; [1991] BCC 82; [1991] BCLC 178, referred to.
(11) *Price Waterhouse* v. *Kwan*, [2000] 3 NZLR 39; [1999] NZCA 311, considered.
(12) *Richards (t/a Colin Richards & Co.)* v. *Hughes*, [2004] P.N.L.R. 35; [2004] EWCA Civ 266, referred to.
(13) *Stone & Rolls Ltd. (In Liquidation)* v. *Moore Stephens (A Firm)*, [2008] 3 W.L.R. 1146; [2008] Bus. L.R. 1579; [2008] 2 Lloyd's Rep. 319; [2008] 2 BCLC 461; [2008] P.N.L.R. 36; [2008] EWCA Civ 644; on appeal, [2009] 1 A.C. 1391; [2009] 3 W.L.R. 455; [2009] 4 All E.R. 431; [2009] Bus. L.R. 1356; [2009] 2 Lloyd's Rep. 537; [2009] 2 BCLC 563; [2009] 2 C.L.C. 121; [2009] B.P.I.R. 1191; [2009] P.N.L.R. 36; [2009] UKHL 39, considered.
(14) *Tinsley* v. *Milligan*, [1994] 1 A.C. 340; [1993] 3 W.L.R. 126; [1993]

3 All E.R. 65; [1993] 2 F.L.R. 963; (1993), 68 P. & C.R. 412, considered.

(15) *West Mercia Safetywear Ltd. (In Liquidation)* v. *Dodd* (1987), 4 BCC 30; [1988] BCLC 250; 1988 PCC 212, referred to.

(16) *White* v. *Jones*, [1993] 3 W.L.R. 730; [1993] 3 All E.R. 481; [1993] N.P.C. 37; on appeal, [1995] 2 A.C. 207; [1995] 2 W.L.R. 187; [1995] 1 All E.R. 691; [1995] 3 F.C.R. 51, considered.

(17) *Williams & Humbert Ltd.* v. *W. & H. Trade Marks (Jersey) Ltd.*, [1986] A.C. 368; [1986] 2 W.L.R. 24; [1986] 1 All E.R. 129, referred to.

(18) *X (Minors)* v. *Bedfordshire C.C.*, [1995] 2 A.C. 633; [1995] 3 W.L.R. 152; [1995] 3 All E.R. 353; [1995] 2 FLR 276; [1995] 3 F.C.R. 337, referred to.

Legislation construed:

Solicitors' (Practising Certificates) Rules 2005, r.4: The relevant terms of this rule are set out at para. 4.

Partnership Act 1895, s.3: The relevant terms of this section are set out at para. 25.

D. Alexander, Q.C., *M. Haywood* and *C. Wright* for the claimants;
L. Baglietto, Q.C., *M. Walsh* and *C. Bonfante* for the defendant.

1 **JACK, J.:**

The background

On July 2nd, 2014, Grigson, Ag. J. convicted the three brothers, Isaac Marrache ("Isaac"), Benjamin Marrache ("Benjamin") and Solomon Marrache ("Solomon"), of two counts of conspiracy to defraud contrary to common law. Isaac and Benjamin were admitted to the Bar of Gibraltar and practised in partnership as "Marrache & Co." Solomon, at least on occasions, presented himself as a partner; however, he had no legal qualifications and was not admitted to the Bar. He could not, therefore, have been a partner in Marrache & Co. He in fact handled the accounts. Nothing in the current application turns on whether Solomon was a partner or not. For convenience, I shall treat only Isaac and Benjamin as partners; my conclusions would be the same even if all three were partners.

2 The essence of the fraud alleged against the three brothers was that they had stolen from the Marrache & Co. client account, stolen from various trusts and trust companies managed by the firm, and misused trust assets to provide security to the Jyske Bank (Gibraltar) Ltd. for loans which they had taken out. The judge subsequently sentenced Isaac to 11 years' imprisonment and his two brothers to 8 years each. An appeal to the

Court of Appeal has been dismissed. There is currently an application to obtain special leave to appeal to the Privy Council.

3 As a result of the defalcations of the Marrache brothers, Marrache & Co. and the individual brothers were hopelessly insolvent. The total deficiency is currently estimated at £28.4m. On March 17th, 2010, the court ordered that Marrache & Co. be wound up as an unregistered company. Mr. Lavarello and Mr. Hyde were appointed as liquidators. In addition, bankruptcy petitions were presented by Portino Comercio International S.A. ("Portino") against each of the brothers individually. By orders of April 30th, 2010 and May 4th, 2010, Mr. Hyde was appointed as special manager of the estates of the three brothers and receiving orders were made. On November 26th, 2010, on Portino's petition, each brother was made bankrupt and Mr. Lavarello was appointed as trustee in bankruptcy.

The claims

4 The defendant ("Baker Tilly") is a firm of chartered accountants. It prepared the financial statements for Marrache & Co. from the year ending June 30th, 1998 to the year ending June 30th, 2008. In addition, r.4 of the Solicitors' (Practising Certificates) Rules 2005, provides:

> "(1) Every solicitor shall produce to the Registrar not later than 31 December in every year a certificate signed by an auditor which satisfies the Registrar that such solicitor has complied with the Solicitors' Accounts Rules for the preceding year.
>
> (2) For the purposes of sub-rule (1) 'the preceding year' means from the 1 July of the year preceding the date of the certificate to 30 June next following."

Pursuant to this rule, Baker Tilly produced accountants' report forms for the years ending June 30th, 2005 up to the year ending June 30th, 2008.

5 The claimants allege that Baker Tilly is liable to pay them damages. They rely on three causes of action, summarized in their skeleton argument as follows:

> "(1) During the course of its engagement by the firm, Baker Tilly acted in breach of contract and/or negligently (and, to the extent necessary, in 'wilful default') by, amongst other things, failing to identify and/or report the wrongful withdrawal of moneys from the firm's client account ('the negligence claim').
>
> (2) A conspiracy existed to defraud and injure the firm by the withdrawal of very significant sums of money from its client account. The parties to that conspiracy included [Isaac, Benjamin, Solomon] and Baker Tilly. Further, or alternatively, the fraudulent

scheme also involved breaches of fiduciary duty by [Isaac, Benjamin and Solomon] to the firm ('the conspiracy claim').

(3) [Isaac, Benjamin and Solomon] breached fiduciary duties owed by them to the firm. Further, or alternatively, [Isaac] breached fiduciary duties he owed to [Benjamin] as his partner and . . . [Benjamin] breached fiduciary duties he owed to [Isaac] as his partner. Baker Tilly dishonestly assisted in those breaches of fiduciary duty ('the dishonest assistance claim')."

The particular acts relied upon are the making of the firm's ordinary financial statements and the accountants' report forms, in each case from the year ending June 30th, 2005. The claim is limited solely to moneys stolen from the client account, not to the claims in respect of trusts, trust companies and Jyske Bank (Gibraltar) Ltd.

Striking out

6 Baker Tilly applies under the Civil Procedure Rules, r.3.4(2) to strike out the whole of the claim. Rule 3.4(2) provides:

"The court may strike out a statement of case if it appears to the court—

(a) that the statement of case discloses no reasonable grounds for bringing or defending the claim; [or]

(b) that the statement of case is an abuse of the court's process or is otherwise likely to obstruct the just disposal of the proceedings . . ."

In addition, Practice Direction 3A gives examples of such cases:

"1.4(3) [Particulars of claim] which contain a coherent set of facts but those facts, even if true, do not disclose any legally recognisable claim against the defendant.

. . .

1.5 . . . where [a claim] is . . . obviously ill founded."

Paragraph 1.7 says:

"A party may believe he can show without a trial that an opponent's case has no real prospect of success on the facts, or that the case is bound to succeed or fail, as the case may be, because of a point of law . . . In such a case the party concerned may make an application under rule 3.4 . . ."

7 The principles on which the court determines whether to strike out a case under r.3.4(2) are not in dispute.

(a) The court must decide the issues on the assumption that the facts pleaded by the claimant are true: *Morgan Crucible Co. plc* v. *Hill Samuel & Co. Ltd.* (10) ([1991] Ch. at 314). (It follows that the court, in deciding the current application, makes no determination whatsoever of the truth of the allegations against Baker Tilly, which makes no admissions.)

(b) "No reasonable grounds for bringing . . . the claim" means that the judge can only strike out the claim if he is certain that the claim is bound to fail: *Richards (t/a Colin Richards & Co.)* v. *Hughes* (12) ([2004] P.N.L.R. 35, at para. 22).

(c) ". . . [I]f an application to strike out involves a prolonged and serious argument the judge should, as a general rule, decline to proceed with the argument unless he not only harbours doubts about the soundness of the pleading but, in addition, is satisfied that striking out will obviate the necessity for a trial or will substantially reduce the burden of preparing for trial or the burden of the trial itself": *Williams & Humbert Ltd.* v. *W. & H. Trade Marks (Jersey) Ltd.* (17) ([1986] A.C. at 435–436).

(d) In areas of difficult or developing jurisprudence, striking out may be inappropriate because developments of the law should be decided on the basis of actual rather than hypothetical facts: *X (Minors)* v. *Bedfordshire C.C.* (18) ([1995] 2 A.C. at 740–741).

Baker Tilly's argument

8 Baker Tilly's argument on the strike-out application is simplicity itself. The claimants stand in the shoes of the Marrache brothers, both individually and collectively. If the Marrache brothers had sued Baker Tilly for any of the three causes of actions pleaded in the particulars of claim, then Baker Tilly would have had an absolute defence of *ex turpi causa non oritur actio*, because the Marraches would be relying on their own wrongful and illegal behaviour in bringing their claim. The claimants can have no better right to sue Baker Tilly than the Marrache brothers had themselves. Accordingly, their case too stands to be struck out.

9 There are two key steps in this argument:

(a) Any claim by the Marraches themselves would be barred by *ex turpi causa.*

(b) The fraud of the Marrache brothers must be attributed to Marrache & Co. and to each of the brothers, so that the claimants, as variously liquidators, trustee in bankruptcy and special manager, can, *vis-à-vis* Baker Tilly, be in no better position than Marrache & Co. and the individual brothers would have been.

Ex turpi causa

10 The precise test to be applied by the courts in determining whether a cause of action is barred by *ex turpi causa* has been the subject of much dispute and no fewer than four Law Commission reports and consultation papers between 1999 and 2010. In 1987, the English Court of Appeal held that the test was in effect discretionary, the question being whether—

> ". . . in all the circumstances it would be an affront to the public conscience to grant the plaintiff the relief which he seeks because the court would thereby appear to assist or encourage the plaintiff in his illegal conduct or to encourage others in similar acts": *Euro-Diam Ltd.* v. *Bathurst* (3) ([1990] 1 Q.B. at 35).

11 That approach was overruled by the House of Lords in *Tinsley* v. *Milligan* (14). A claimant "is entitled to recover if he is not forced to plead or rely on the illegality" ([1994] 1 A.C. at 376). This approach was explained by Rimer, L.J. in *Stone & Rolls Ltd. (In Liquidation)* v. *Moore Stephens (A Firm)* (13) in the English Court of Appeal in these terms ([2008] 3 W.L.R. 1146, at para. 16):

> "The relevant question it identifies is whether, to advance the claim, it is necessary for the claimant to plead or rely on the illegality. If it is, the *Tinsley* case decided that the axe falls indiscriminately and the claim is barred, however good it might otherwise be. There is no discretion to permit it to succeed."

12 When *Stone & Rolls* reached the House of Lords, there was disagreement between the Law Lords as to the test for *ex turpi causa.* Lord Phillips of Worth Matravers did not accept that the passage I have cited from Rimer, L.J.'s judgment was a full statement of the law ([2009] 1 A.C. 1391, at para. 23). He approved Beldam, L.J.'s comments in *Cross* v. *Kirkby* (2) (*The Times*, April 5th, 2000, para. 76) that there was no—

> ". . . general principle that the claimant must either plead, give evidence of or rely on his own illegality for the principle to apply. Such a technical approach is entirely absent from Lord Mansfield, C.J.'s exposition of the principle [in *Holman* v. *Johnson* (5) (1 Cowp. at 343; 98 E.R. at 1121)]."

13 Lord Scott of Foscote ([2009] 1 A.C. 1391, at para. 97) and Lord Walker of Gestingthorpe (*ibid.*, at para. 131), by contrast, approved the test in *Tinsley*. The main issue in the case was a different issue, namely the question of attribution, in other words, the extent to which the acts of the fraudster, who was both the sole director and sole shareholder in the company, stood to be attributed to the company. It was on this point that the panel divided 3:2, with the majority holding that the fraudster's acts and knowledge did stand to be so attributed. There was no disagreement

that, if his actions were to be so attributed, then *ex turpi causa* barred a claim against the defendant auditors who had failed to detect his fraud.

14 The UK Supreme Court has revisited the test for *ex turpi causa* in no fewer than three cases: *Hounga* v. *Allen* (6); *Les Laboratoires Servier* v. *Apotex Inc.* (9); and *Jetivia S.A.* v. *Bilta (UK) Ltd.* (7). In the last of these, Lord Neuberger said ([2016] A.C. 1, at para. 15) that "the proper approach to the defence of illegality needs to be addressed by this court (certainly with a panel of seven and conceivably with a panel of nine Justices) as soon as appropriately possible . . ."

15 Lord Neuberger in *Bilta* (*ibid.*, at para. 14) pointed out that there was, in *Bilta* itself, disagreement between the Justices of the UK Supreme Court as to the correct test for *ex turpi causa*:

> ". . . Lord Sumption, JSC considers that the law is stated in the judgments in the House of Lords in *Tinsley* v. *Milligan* . . . which he followed and developed (with the agreement of three of the four other members of the court, including myself and Lord Clarke, JSC) in *Les Laboratoires Servier* v. *Apotex Inc* . . . He distinguishes the judgment of Lord Wilson, JSC in *Hounga* v. *Allen* . . . as involving no departure from *Tinsley* v. *Milligan,* but as turning on its own context in which 'a competing public policy required that damages should be available even to a person who was privy to her own trafficking' (para 102). By contrast Lord Toulson, JSC (who dissented from that approach in the *Les Laboratoires* case) and Lord Hodge, JSC favour the approach adopted by the majority of the Court of Appeal in *Tinsley* v. *Milligan* and treat that of Lord Wilson, JSC in para 42ff of *Hounga* v. *Allen* as supporting that approach."

16 The claimants submit that this difference of view on the test for *ex turpi causa* means that this is an area of "difficult or developing jurisprudence," so that striking out was inappropriate. I agree that, if the precise test were relevant in this case, it would for that reason be inappropriate for me to strike the case out. However, in my judgment, the precise test is irrelevant in considering the Marrache brothers' behaviour. On any view, the conspiracy to defraud committed by the Marraches would have barred any claim by the Marraches themselves beneficially against Baker Tilly by virtue of *ex turpi causa.*

17 I have considered whether it might be arguable that the claimants are in a different position from the Marraches themselves. In other words, if the discretionary *Euro-Diam* (3) approach were to be preferred to the strict line in *Tinsley* (14), could the liquidators say that the court should exercise its discretion more favourably to them than it would have exercised its discretion *vis-à-vis* the Marrache brothers themselves? In my judgment, however, this must be wrong as a matter of principle. If, before the liquidation and bankruptcies began, the Marraches had no claim against

Baker Tilly, then a cause of action could not suddenly spring to life once the liquidation and bankruptcies began.

18 There is a separate argument presented by the claimants in relation to the Solicitors' (Practising Certificates) Rules 2005. The claimants argue that, even if *ex turpi causa* applied, there are countervailing considerations of public policy which mean that the claims should not be struck out. I shall consider this point below.

Attribution

19 I turn to the question of whether the claimants stand in the shoes of the Marraches. The claimants argue that the partners owed fiduciary duties to the firm, which the liquidators can enforce, and that an agent's wrongful act against the firm cannot be attributed to the firm. The leading case on attribution is now *Bilta* (7), but this was a case involving a limited company, not a partnership.

20 In *Bilta*, the two directors, one of whom was also the sole shareholder, had used the company as a vehicle for carrying out frauds. Once the frauds came to light, the company was put into liquidation and the liquidators sought to recover damages from the directors. The directors argued that, since their knowledge had to be attributed to the company, the company, as a fellow conspirator, could not sue the directors by reason of *ex turpi causa.*

21 The defendant directors in *Bilta* relied on *Stone & Rolls* (13), but the UK Supreme Court held ([2016] A.C. 1, at para. 30) that *Stone & Rolls*, insofar as it concerned attribution, was a case on its own facts, which should not "be treated as authoritative or of assistance . . ." It is true that the Gibraltar Parliament, after the decision in *Stone & Rolls* but before *Bilta*, enacted the Insolvency Act 2011. This Act does not reverse *Stone & Rolls*, but there is no evidence that Parliament intended to approve that decision when it passed the legislation. Accordingly, I do not consider that this is material to the authority to be attached to *Stone & Rolls*.

22 Lord Neuberger summarized the court's reasoning on attribution in *Bilta* (*ibid.*, at para. 7):

> "Where a company has been the victim of wrongdoing by its directors, or of which its directors had notice, then the wrongdoing, or knowledge, of the directors cannot be attributed to the company as a defence to a claim brought against the directors by the company's liquidator, in the name of the company and/or on behalf of its creditors, for the loss suffered by the company as a result of the wrongdoing, even where the directors were the only directors and shareholders of the company, and even though the wrongdoing or

knowledge of the directors may be attributed to the company in many other types of proceedings."

23 The defendant argues that this holding, known as the *Hampshire Land* principle (see *In re Hampshire Land Co. (No. 2)* (4)), has no application to a partnership because the rules of attribution are quite different. A partnership, it argues, both at common law and under statute, has no legal personality.

24 The claimants suggested faintly in their particulars of claim that, because Marrache & Co. had been wound up as an unregistered company under s.352 of the Companies Act 1930, it therefore had a sufficiently separate legal personality to mean that the *Bilta* principle could apply. There are some attractions to this suggestion from a comparative law perspective. The traditional German view was that the equivalent of a partnership in that jurisdiction, a Gesellschaft bürgerlichen Rechts ("GbR"), had no legal personality. By a decision of January 29th, 2001 (1), the Bundesgerichtshof (the Federal Court of Justice) held, contrary to its previous jurisprudence, that a GbR (a) could have rights itself, and (b) was capable of suing and being sued. These two criteria are the classic indicators of legal personality.

25 In English law too, partnerships can (and indeed should) sue and be sued in their firm's name: CPR, r.7.2A and Practice Direction 7A, paras. 5A.1 and 5A.3. However, any rights of the partnership are rights of the partners jointly, not rights of a separate entity. The weight of common law authority is overwhelmingly against a partnership having legal personality; it is simply a "relation which subsists between persons carrying on a business in common with a view of profit": Partnership Act 1895, s.3.

26 In the event, the claimants, in my judgment rightly, abandoned this argument in their skeleton argument and did not seek to revive it in oral argument. Accordingly, I hold that Marrache & Co. never had legal personality separate from that of Isaac and Benjamin.

27 The claimants instead argue that the assets of the partnership have to be treated differently from the assets of the individual partners. That is undoubtedly right: see the Partnership Act 1895, ss. 22(1) (partnership property) and 25(1) (execution prohibited against partnership property save under a judgment against the firm).

28 This, however, does not, in my judgment, take the claimants far enough. In the case of a limited company, once the company is insolvent, the directors are under a duty to take steps, such as winding it up, in order to protect creditors: see *Bilta* (7) ([2016] A.C. 1, at paras. 126–127). The directors owe a fiduciary duty to the company to do that. If they fail to do so, the liquidators can sue the directors for breach of that duty: see *West Mercia Safetywear Ltd. (In Liquidation)* v. *Dodd* (15).

29 Individuals owed no analogous duty to protect creditors after an act of bankruptcy (in other words, the onset of insolvency) but before the making of a receiving order. It is only after a receiving order was made that a duty was placed on a debtor to account for his property: Bankruptcy Act 1934, s.21. It may be arguable that the situation was (and is) different with regard to a partnership, because a partnership could have been wound up (as was Marrache & Co.) under s.352 of the Companies Act 1930. On this argument, once the partnership was insolvent, the partnership assets would be held on a trust for the creditors and the partners would be obliged to petition for the winding up of the partnership as an unregistered company. However, this does not, in my judgment, help the liquidators, because it gives no separate entity any freestanding right to enforce the trust for the benefit of the creditors. The partnership is never anything more than the relationship between the partners. It is not possible to separate the firm from the partners (see *Lindley & Banks on Partnership*, 19th ed., at para. 2–35 (2013)), unlike the situation of a limited company, where it is easy to treat the directors and shareholders as wholly distinct from the company.

30 The claimants also argue that the *Hampshire Land* principle applies. They define the principle as being "that an agent's wrongdoing and/or knowledge [are] not to be attributed to his principal if the agent's wrongdoing is directed against the principal."

31 Now it is true that "[e]very partner is an agent of the firm": Partnership Act 1895, s.7. However, here each brother's wrongdoing was not directed against the firm: all the partners in the firm were in full agreement that the wrongdoing should take place. There was no innocent principal who could be wronged. This, in my judgment, is a key element of *Hampshire Land* (4). Accordingly, there is no scope for the *Hampshire Land* doctrine to apply.

32 In my judgment, the claimants stand in the shoes of Isaac, Benjamin and Solomon. Baker Tilly can thus, subject to the claimants' final argument, rely on *ex turpi causa* to defeat the claims against it.

The Solicitors' (Practising Certificates) Rules 2005

33 The claimants' fall-back argument is based on Baker Tilly's giving the accountants' report forms which stand to be signed under r.4 of the Solicitors' (Practising Certificates) Rules 2005, which I have set out in para. 4 above. There are two ways in which this argument is put. The first is that there is a "requirement that a cause of action lies against an accountancy firm which has signed accountants' report forms in accordance with r.4." The second is that *ex turpi causa* is a rule of public policy which should not prevail if there is a countervailing and stronger public policy argument.

34 So far as the first argument is concerned, when I read the skeleton arguments, I drew the parties' attention to *Law Society* v. *KPMG Peat Marwick* (8). In that case, the defendant auditors had failed to discover defalcations on a solicitor's client account caused by the fraud of the partners. The Law Society of England and Wales ran the compensation fund which paid the clients who had lost money as a result of the fraud. The Law Society sought to recover the losses from the auditors. The English Court of Appeal held (reading from the headnote) ([2000] 1 W.L.R. at 1922)—

> ". . . that it was obvious that if protective action was not taken by the Law Society because an accountant's report did not draw attention to irregularities in a firm's accounts that could have adverse consequences on the compensation fund; that there was no reason why the accountants should not owe a private law duty to the Law Society, the performance of which would assist it to perform its public, or regulatory, duties . . . and that, accordingly, since there had been reasonable foreseeability of damage, a relationship of sufficient proximity and the imposition of a duty of care was fair, just and reasonable in the circumstances, the accountants had owed a duty of care to the Law Society when preparing the annual reports on the firm's accounts . . ."

35 In Gibraltar, there is no compensation fund, yet the purpose of r.4 is just the same as the corresponding provisions for auditors' reports in England. There are logically only three possibilities in respect of a claim for breach of r.4: (a) that individual clients of Marrache & Co. have a claim against Baker Tilly; (b) that the claimants have a claim; or (c) that no one has a claim. (c) is, of course, Baker Tilly's preferred option. However, it necessarily entails that the failure on the part of the auditor to give an accountants' report form complying with r.4 would have no legal consequences.

36 (a) is problematic because there may not be a "relationship of sufficient proximity" between Baker Tilly on the one hand and the individual clients of Marrache & Co. on the other. There are two conflicting lines of authority on this.

37 Mr. Baglietto, Q.C. drew my attention to the New Zealand Court of Appeal decision in *Price Waterhouse* v. *Kwan* (11). The court was considering an application by a solicitor's auditor to strike out a claim by a client in respect of deficiencies on the solicitor's trust account which the auditor had failed to identify. The court held ([2000] 3 NZLR 39, at para. 25) that—

> ". . . Price Waterhouse must fail in its contention that there is no tenable case for imposing the duty of care in issue. Indeed we consider there is a clear *prima facie* case for such imposition, which

should be confirmed at trial unless there emerges some evidence providing policy reasons of sufficient force to lead to the opposite conclusion. The duty for which there is clear *prima facie* support can be framed quite simply. Causation issues are properly dealt with as a subsequent and separate enquiry and should not unnecessarily intrude into the formulation of the duty of care and its scope. An auditor of a solicitor's trust account owes to current clients of the solicitor a duty to conduct the audit with reasonable skill and care. The auditor is liable to such clients for any loss caused or contributed to by the auditor's failure to exercise such reasonable skill and care."

38 The New Zealand court's formulation of the duty of care as limited to "current clients" implies that the auditor owed no duty to subsequent clients. Here, for example, Baker Tilly's last accountant report form was for the year ending June 30th, 2008, yet it was only in 2010 that the fraud was discovered. It is very likely that the clients and the moneys held in trust for them in 2010 were different from those in 2008, because money is generally deposited in solicitors' client accounts for short-term transactional purposes. On this authority, the 2010 clients could not complain that they have lost their money because Baker Tilly failed to blow the whistle earlier, as it should have done.

39 The *KPMG* case (8), by contrast, would appear to allow the Law Society to claim in respect of the equivalent of the 2010 clients' losses.

40 The differences were discussed in *Stone & Rolls* (13). Lord Phillips appears to prefer the *Price Waterhouse* limitation on the extent of the duty of care. He asked ([2009] 1 A.C. 1391, at para. 5)—

"Why . . . should the banks not have a direct cause of action in negligence against Moore Stephens? One answer, I would suggest, is that a duty of care in negligence will only arise where this is fair, just and reasonable. It would not be considered fair, just and reasonable for auditors of a company to owe a duty of care to an indeterminate class of potential victims in respect of unlimited losses that they might sustain as a result of the fraud of the company. If it would not be fair, just and reasonable for the banks to have a direct claim, then it would not seem fair just and reasonable that they should achieve the same result through a claim brought by the company's liquidators for their benefit."

41 However, Lord Mance's view was different. He discussed (*ibid.*, at para. 259)—

". . . a situation analogous to that applying where a person (A) undertakes to report to a professional body on the affairs of a third person (B) to enable B to continue to engage in professional practice. If B procures A to issue the relevant certificate by deceiving A about

> matters which A, had he been careful, should anyway have observed, B cannot then turn round and blame A: *Luscombe* v. *Roberts* (1962) 106 SJ 373. But the professional body, if it incurs loss through allowing B to continue in practice, can in such a situation claim against A [citing *KPMG*]."

42 Is it a permissible development of the law to treat the liquidators as the equivalent of the Law Society? This would undoubtedly be a development of the law beyond its current state. Nonetheless, the possibility of such a development cannot, in my judgment, be rejected summarily. It would remedy the unfairness which would arise if defrauded clients in England received compensation and the auditors picked up the cost, whereas the absence of a compensation fund in Gibraltar would result in clients here receiving no compensation (assuming the *Price Waterhouse* limitation on making a direct claim is good law).

43 There is some analogy with *White* v. *Jones* (16). In that case, a solicitor had failed timeously to draw up a will and the would-be testator died before executing it. The defendant solicitor argued that he owed the disappointed would-be beneficiaries no duty of care, so that no claim lay at their suit. Sir Donald Nicholls, V.-C. held in the English Court of Appeal ([1993] 3 W.L.R. at 739–740):

> "I think it must be frankly recognised that if the court holds a solicitor liable to an intended beneficiary, what the court is doing is fashioning an effective remedy for the solicitor's breach of his professional duty to his client. I do not shrink from this. If this sounds heretical to some, I pray in aid the observation of Deane, J. in the High Court of Australia in *Hawkins* v. *Clayton* (1988) 164 C.L.R. 539, 584, in a case concerned with a solicitor's liability to make reasonable efforts to locate the executor named in a will held by him in safe custody when he learns of the testator's death:
>
>> 'The law of contract and the law of tort are, in a modern context, properly to be seen as but two of a number of imprecise divisions, for the purpose of classification, of a general body of rules constituting one coherent system of law.'
>
> Here, a coherent system of law demands that there should be an effective remedy against the solicitor. The law of contract is unable to provide the remedy. In some cases, where the purpose of a contract is to confer a benefit on a third party, the purpose can be achieved, in the event of breach, by the court making an order compelling the party in breach specifically to perform his obligation to make a payment or confer some other benefit on a third party: see *Beswick* v. *Beswick* [1968] A.C. 58."

44 That approach was approved by the majority in the House of Lords. Lord Browne-Wilkinson said ([1995] 2 A.C. at 270):

> ". . . I agree that your Lordships should hold that the defendant solicitors were under a duty of care to the plaintiffs arising from an extension of the principle of assumption of responsibility explored in *Hedley Byrne and Co. Ltd.* v. *Heller & Partners Ltd.* [1964] A.C. 465. In my view, although the present case is not directly covered by the decided cases, it is legitimate to extend the law to the limited extent proposed using the incremental approach by way of analogy advocated in *Caparo Industries Plc.* v. *Dickman* [1990] 2 A.C. 605."

45 In my judgment, it is arguable that, by allowing the liquidators to sue in respect of the accountants' report forms, the court would be fashioning a remedy which would ensure that the purpose of r.4 was fulfilled. The remedy would be to give the liquidators a claim against Baker Tilly for breach of r.4. This claim would be held by the liquidators on trust for the clients with money in the client account in 2010. That would mean that any recovery from Baker Tilly would not stand to be distributed to the trade and other creditors of Marrache & Co.

46 There may be an issue as to precisely what cause of action was held on trust. Would it be solely the negligence claim? If so, then the conspiracy claim and the dishonest assistance claim could only be brought at the suit of the defrauded client. I also note that those two claims, as currently pleaded, are directed at a fraud on the firm, not on the body of clients of Marrache & Co. I did not hear any argument on the point, so I make no determination on it. It may be that amendments will need to be made.

47 So far as the second argument is concerned, the claimants rely on *Hounga* v. *Allen* (6) and the joint judgment of Lord Toulson and Lord Hodge in *Bilta* (7). *Hounga* concerned a claim for race discrimination by a Nigerian against her employer. She was an illegal immigrant brought into the United Kingdom by her employer; her contract of employment was therefore vitiated by illegality. Lord Wilson ([2014] 1 W.L.R. 2889, at para. 42) said that "it is necessary, first, to ask 'What is the aspect of public policy which founds the defence?' and, second, to ask 'But is there another aspect of public policy to which application of the defence would run counter?'"

48 The Supreme Court went on to consider that the fact that Miss Hounga had been trafficked by Mrs. Allen was an important policy consideration which outweighed the illegality of the contract of employment.

49 The judgment of Lord Toulson and Lord Hodge in *Bilta* is to the same effect ([2016] A.C. 1, at paras. 129–130):

"129 It has been stated many times that the doctrine of illegality has been developed by the courts on the ground of public policy. The context is always important. In the present case the public interest which underlies the duty that the directors of an insolvent company owe for the protection of the interests of the company's creditors, through the instrumentality of the directors' fiduciary duty to the company, requires axiomatically that the law should not place obstacles in the way of its enforcement. To allow the directors to escape liability for breach of their fiduciary duty on the ground that they were in control of the company would undermine the duty in the very circumstances in which it is required. It would not promote the integrity and effectiveness of the law, but would have the reverse effect. The fact that they were in sole control of the company and in a position to act solely for their own benefit at the expense of the creditors, makes it more, not less, important that their legal duty for the protection of the interests of the creditors should be capable of enforcement by the liquidators on behalf of the company.

130 For that reason in our judgment this appeal falls to be dismissed. The courts would defeat the very object of the rule of law which we have identified, and would be acting contrary to the purpose and terms of sections 172(3) and 180(5) of the Companies Act 2006, if they permitted the directors of an insolvent company to escape responsibility for breach of their fiduciary duty in relation to the interests of the creditors, by raising a defence of illegality to an action brought by the liquidators to recover, for the benefit of those creditors, the loss caused to the company by their breach of fiduciary duty. In everyday language, the purpose of the inclusion of the creditors' interests within the scope of the fiduciary duty of the directors of an insolvent company towards the company is so that the directors should not be off the hook if they act in disregard of the creditors' interests. It would be contradictory, and contrary to the public interest, if in such circumstances their control of the company should provide a means for them to be let off the hook on the ground that their illegality tainted the liquidators' claim."

50 It is right to say that Lord Sumption took a different approach and Lord Neuberger held that it was inappropriate to decide the matter finally in the light of the way *Bilta* had been argued. However, in my judgment, it is arguable on the basis of the passage cited that the public interest in ensuring a meaningful remedy against auditors for breach of their r.4 duties does outweigh what would otherwise be an unanswerable defence of *ex turpi causa.*

51 Now, this would, for the reasons I gave in para. 17 above, mean that, even before the insolvency proceedings began, Marrache & Co. had a claim against Baker Tilly. However, if the trust remedy exists, this is not

an insuperable problem: Marrache & Co. would hold the claim against Baker Tilly on trust for its clients. On the appointment of the liquidators and the trustee in bankruptcy, the trust claim would simply pass to the claimants.

The pleadings

52 Mr. Baglietto, Q.C. in his reply submitted that the r.4 claim was not properly pleaded in the particulars of claim, so that even if a claim could lie, as discussed above, in the absence of any amendment, the claim still stood to be struck out. I agree with him that the particulars of claim do not make an express legal analysis of the r.4 claim in the way discussed above.

53 That, however, is not, in my judgment, fatal to the claimants' claim. The primary requirement of particulars of claim is that they include "a concise statement of the facts on which the claimant relies": CPR, r.16.4(1)(a). All the facts on which the claimants rely here are set out in the existing particulars of claim. Although it is often good practice to plead the law, it is not a requirement.

54 It happens not infrequently on strike-out applications, particularly where new law is concerned, that a party's legal case develops in the course of the hearing. That is perfectly permissible (although it may have costs consequences). No doubt the claimants will wish to amend their particulars of claim, but that is a matter on which I can give directions.

Conclusion

55 Although I have rejected the claimants' case in respect of the matters in the sections "*Ex turpi causa*" and "Attribution" above, the point on r.4 is sufficiently arguable that it would, in my judgment, be wrong to strike the case out. Moreover, liability in respect of accountants' report forms is a developing area of law.

56 Although case management considerations are not relevant to a strike-out application, it should be noted that there is at least one victim of the Marraches' fraud who has brought a claim against Baker Tilly directly. It may be desirable to have both cases tried together. If Baker Tilly denies any direct duty of care to the victim, the point of law as to whether the claimants can sue instead can be determined against the full factual background.

57 I have considered whether the claim insofar as it rests on the financial statements (as opposed to the accountants' report forms) should be struck out. However, in my judgment there is no purpose in doing so. The

financial statements are intimately wrapped up with the accountants' report forms, since the latter, I assume, will be based on the former.

Application dismissed.