Application to strike out the Plaintiff's Cause of Action pursuant to rule 52(2) of the Royal Court Civil Rules, 2007.

[2020]GRC021

IN THE ROYAL COURT OF GUERNSEY

(ORDINARY DIVISION)

Between:

PROVIDENCE INVESTMENT FUNDS PCC LIMITED (MANAGED BY ADMINISTRATION MANAGERS)

Plaintiff

-and-

PRICEWATERHOUSECOOPERS CI LLP

Defendant

Defendant's application to strike out Cause

Hearing date: 5th December 2019

Judgment handed down: 15th May 2020

Before: Richard James McMahon, Esq., Bailiff

Counsel for the Defendant: **Advocates I C Swan and T W McGuffin**
Counsel for the Plaintiff: **Advocates M C Newman and S Dingle**

Cases, texts & legislation referred to:

The Royal Court Civil Rules, 2007
The Companies (Guernsey) Law, 2008
The Protection of Investors (Bailiwick of Guernsey) Law, 1987
The Registered Collective Investment Schemes Rules, 2008
AssetCo Plc v Grant Thornton UK LLP [2019] EWHC 150 (Comm)
Berg Sons & Co Ltd v Adams [1992] BCC 661
Galoo Ltd v Bright Grahame Murray [1994] 1 WLR 1360
Caparo Industries plc v Dickman [1990] 2 AC 605
Bilta (UK) Limited (in liquidation) v Nazir [2016] AC 1
Stone & Rolls Limited v Moore Stephens [2009] AC 1391
Singularis Holdings Ltd (in official liquidation) v Daiwa Capital Markets Europe Ltd [2019] UKSC 50
Pilmer v Duke Group Limited [2001] HCA 31
Tranquillity Holdings Limited v Invista Real Estate Investment Management (CI) Limited (unreported, 13 August 2015)
Jakob International Inc. v HSBC Private Bank (CI) Limited (unreported, 1 July 2016)
Salzedo and Singla, *Accountants' Negligence and Liability*
Sew Hoy & Sons Ltd v Coopers & Lybrand [1996] 1 NZLR 392

MAN Nutzfahrzeuge AG v Freightliner Ltd [2004] PNLR 19
Heather Capital Limited (in liquidation) v KPMG Audit LLC (unreported, 17 November 2015)
Morton v Paint (1996) 21.GLJ.61
The New Flamenco [2017] 1 WLR 2581
Sasea Finance Ltd (in liquidation) v KPMG [2000] 1 All ER 676
South Australia Asset Management Corp v York Montague Ltd [1997] AC 191

Introduction

1. By an Application dated 20 September 2019, the Defendant, PricewaterhouseCoopers CI LLP, seeks an order that the Cause of the Plaintiff in this action, Providence Investment Funds PCC Limited (which is managed by Administration Managers appointed by this Court in August 2016 on the application of the Guernsey Financial Services Commission ("the GFSC")), be struck out pursuant to rule 52(2) of the Royal Court Civil Rules, 2007. That Application was heard on 5 December 2019, when judgment was reserved.

2. The Application is supported by the Affidavit of Kirthi Kalyan, sworn on 20 September 2019, which exhibits the pleadings in the action and some correspondence exchanged between the parties' Advocates in July 2019. On behalf of the Plaintiff, one of the Administration Managers, Alexander Adam, has sworn an Affidavit on 23 October 2019, which exhibits the Scheme Particulars dated 13 June 2012, the Plaintiff's Articles of Incorporation and the financial statements for 2013 and 2014 audited by the Defendant, both of which are dated 27 April 2016. Mr Adam also offers some additional information about the nature of the Plaintiff's business and the type of investor it attracted.

3. The Court had the benefit of Skeleton Arguments on behalf of both parties. They were exchanged sequentially. In the Defendant's reply dated 15 November 2019, Advocate McGuffin clarified that the application is brought solely pursuant to para. (a) of rule 52(2). Because that Skeleton Argument in reply referred to a decision handed down in England since the Plaintiff's responsive Skeleton Argument, Advocate Newman commented further in a short Skeleton Argument dated 27 November 2019. At the hearing, Advocate Swan appeared on behalf of the Defendant and Advocate Newman on behalf of the Plaintiff. I am grateful to both of them for their helpful submissions and apologise to the parties for having taken longer than I would have wished to be able to hand down this reserved judgment.

Background and procedural matters

4. The Plaintiff's Cause dated 14 December 2018 was tabled on 21 December 2018. The Defences and Counterclaim are dated 15 March 2019. The Plaintiff's Réplique and Defences to Counterclaim are dated 26 April 2019. The Defendant's Duplique and Réplique to Defences to Counterclaim are dated 31 May 2019. The Plaintiff's short Duplique to Réplique to Defences to Counterclaim is dated 14 June 2019. On 31 May 2019, the Defendant requested further information of the Plaintiff's Cause and its Réplique and Defences to Counterclaim. The Plaintiff responded on 17 June 2019. These materials form the parties' pleaded cases.

5. In summary, the basic facts are that the Plaintiff (to which I will refer as "PIF") was incorporated as a protected cell company under Part XXVII of the Companies (Guernsey) Law, 2008, as amended, on 1 March 2012. It forms part of a wider group of Providence companies. On 13 June 2012, PIF was registered by the GFSC as a closed-ended collective investment scheme under the Protection of Investors (Bailiwick of Guernsey) Law, 1987, as amended, and the Registered Collective Investment Schemes Rules, 2008, which have since been repealed and replaced by later Rules. As explained in the Scheme Particulars and the Supplemental Particulars for the various cells, PIF was established as an investment fund that

offered "*an opportunity to invest in a structure that aims to provide an attractive level of return on a reduced risk basis … by providing access to Brazilian debt factoring opportunities*". Investors subscribed for various classes of preference shares. Those Particulars also identified the Defendant as the company's auditor, a role undertaken by it both for 1 October 2012 to 31 December 2013 and for the year ended 31 December 2014. The Particulars further identified that the principal person behind the Providence group was Antonio Buzaneli.

6. Mr Buzaneli entered into a plea agreement in the United States of America on 19 April 2018. He pleaded guilty to conspiracy to commit mail fraud in connection with the operations of the Providence group. Two of his associates have since entered into similar agreements. The Plaintiff's case is that PIF was operated as a fraudulent Ponzi scheme. As a result, the majority of the monies subscribed by investors for preference shares was not invested in Brazil but diverted instead to PIF's parent company, Providence Global Limited, where it was used for the personal and business benefits of Mr Buzaneli and his associates. In total, approximately £37 million was invested and this action seeks to recover approximately £14 million. It is alleged that by 11 May 2015 at the latest, the Defendant was at fault as the Plaintiff's auditor in failing to identify that such a fraud might and probably did exist by failing to report it to the GFSC or to the Plaintiff and by providing clean audit opinions for both of the financial periods which it audited.

7. Once pleadings had closed, the basis on which the current Application is advanced was foreshadowed in correspondence. The Defendant's Advocates wrote to the Plaintiff's Advocates on 15 July 2019 raising the two bases on which the strike-out Application is now advanced. In their replies dated 17 and 24 July 2019, the Plaintiff's Advocates rejected those arguments, referring to some of the authorities on which the Plaintiff now relies. The Application duly followed.

The parties' contentions summarised

8. The Defendant sets out the two issues on which it relies in its Skeleton Argument in the following way:

    (a) The Cause fails to identify persons to whom it is alleged the Defendant should have reported, who in fact relied upon the audit report, and who would, if not for the matters complained by the Plaintiff, have acted differently in their capacity as an organ of the company so as to avoid the loss claimed. The Cause, therefore, fails to make an adequate plea of causation, meaning it is liable to be struck out. This is labelled as the "no legal causation argument".

    (b) The Plaintiff's case on loss is untenable as a matter of law for the reasons pleaded in the Defendant's Defences and Counterclaim because the Plaintiff's case on loss comprises an allegation that the Plaintiff received and disbursed a sum which it would otherwise neither have received nor disbursed. This amounts to alleging a net neutral position, not an allegation of loss. This is labelled as the "no loss argument".

9. It is common ground between the Advocates that the no legal causation argument has not been addressed before in Guernsey. Accordingly, reliance is placed on how it has developed elsewhere, particularly in England and Wales, for how it ought to be found to operate in this jurisdiction.

10. The Defendant's Advocates use a recent example of the application of the principle as highlighting what was already established. The case is *AssetCo Plc v Grant Thornton UK LLP* [2019] EWHC 150 (Comm), a very long judgment of Bryan J, but which involved auditors. The principle is that factual causation alone is insufficient and, as explained in *Berg Sons & Co Ltd v Adams* [1992] BCC 661, legal causation "*involves the relationship between the loss or damages suffered by the plaintiff and the fault of the defendant*". By reference to *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1360, also an auditor case, the law distinguishes between a breach that was the effective legal cause of the loss and one that was merely the occasion of the loss. This means that, for a claim against an auditor to succeed, a plaintiff must be able to show that some natural person acting on the company's behalf would have acted differently but for the alleged breach.

11. The Plaintiff's Advocates suggest that this amounts to an attempt to introduce a principle that has not found favour in cases reaching the House of Lords and the Supreme Court and that other cases, such as *Caparo Industries plc v Dickman* [1990] 2 AC 605, offer examples of the type of loss recoverable from auditors. Further, in *Bilta (UK) Limited (in liquidation) v Nazir* [2016] AC 1, the approach taken in *Stone & Rolls Limited v Moore Stephens* [2009] AC 1391 was subjected to some criticism. They make the point that the scheme of the legislative regime shows that investors are to be protected and that this must mean that the preference shareholders are the primary stakeholders and so they are persons who were entitled to rely on the Defendant. The Plaintiff has already made clear that it is not alleging that the local directors were dishonest participants in the fraud and, if necessary, an amendment to the pleaded case could meet the concerns raised on behalf of the Defendant. They also point out that there are various cases in England and Wales at the moment going on appeal, including the *AssetCo* case, which implies that the area of auditors' liability in negligence is one where the jurisprudence continues to develop.

12. In reply, the Defendant's Advocates address each of the points made in the Plaintiff's Skeleton Argument. They explain that they place no reliance on the *Stone & Rolls* decision. They distinguish between shareholders with voting rights, who can be treated as an organ of a company, and preference shareholders who have no such rights and so cannot. The principle from the *Berg Sons* case had very recently been endorsed by the Supreme Court in *Singularis Holdings Ltd (in official liquidation) v Daiwa Capital Markets Europe Ltd* [2019] UKSC 50. (These arguments are addressed by the Plaintiff's Advocates in the short supplemental Skeleton Argument and, as with the other cases on which both parties rely, I will return to them in more detail in due course.) The Defendant's Advocates clarify that the point being taken by the Defendant is not merely a matter of form, but requires the identification of an innocent manager or director who would have acted differently so that the Defendant can know the case it has to meet in advance and prepare accordingly. In general, the Defendant's Advocates submit that the fact that the Plaintiff has chosen not to avail itself of the opportunity to re-plead its case in the manner it is suggested is required should be held against it now and no opportunity to deal with this issue by way of further pleading should be permitted.

13. Turning to the no loss argument, the Defendant's Advocates point out that para. 140 of the Cause is inadequate because it demonstrates a net neutral position. It reads:

> "*Had PwC discharged its duties and obligations to PIF, either the directors and management of PIF or the GFSC, or both, would have ensured that promptly upon receipt of the necessary report from PwC, PIF ceased to accept further subscriptions from investors and collected in all assets within its reach. PIF would then have avoided the loss of £14,012,730.38 in investors' money received and disbursed after 11 May 2015.*"

The position is not resolved by the Plaintiff's Réplique and Defences to Counterclaim, para. 13 of which denies that the allegation of loss is inadequately particularised or otherwise defective, referring to para. 140 of the Cause which "*makes it clear that the loss suffered is the sums received "and disbursed" from the date at which the fraud would have been discovered*". The Defendant accepts that raising and retaining money from shareholders is a benefit to a company (referring to *Pilmer v Duke Group Limited* [2001] HCA 31) which must then be brought into account in respect of the act of disbursing it, creating the net neutral position.

14. The Plaintiff's Advocates comment that the Plaintiff received subscription monies of around £14 million which it could have invested properly or simply retained, but which instead were stolen from it, which would not have happened had the Defendant detected the fraud then existing. They note that a similar argument was aired before Bryan J in the *AssetCo* case and rejected. The Defendant's Advocates suggest that the position in that case was quite different from the position in the current case and so no weight can be placed on the analysis undertaken.

15. Before I deal with each of the arguments advanced on behalf of the Defendant as a reason for striking out the Cause, I will deal briefly with the law on strike out applications, about which the Advocates were largely agreed.

Legal principles: striking out

16. Rule 52(2)(a) of the 2007 Rules provides that:

> "*The Court may strike out a pleading if it appears to the Court –*
>
> *(a) that the pleading discloses no reasonable grounds for bringing or defending an action ...*".

17. The Advocates have referred to the summary of principles extracted from previous decisions in this Court set out by the Bailiff in *Tranquillity Holdings Limited v Invista Real Estate Investment Management (CI) Limited* (unreported, 13 August 2015) at para. 47:

> "*a) Claims which are suitable for striking out on ground (a) include those which raise an unwinnable case where continuation of the proceedings is without any possible benefit to the respondent and would waste resources on both sides (Harris v Bolt Burdon [2000] L.T.L., February 2, 2000, CA).*
>
> *b) The principal test is whether the party's case is "bound to fail", which creates a high threshold before a pleading, or part thereof, will be struck out. Simply because a case might be weak is not sufficient to justify striking out.*
>
> *c) A statement of case is not suitable for striking out if it raises a serious issue of fact which can only be properly determined by hearing oral evidence (Bridgeman v McAlpine-Brown January 19, 2000, unrep, CA).*
>
> *d) Where a statement of case is found to be defective, the court should consider whether that defect might be cured by amendment and, if it might be, the court should refrain from striking it out without first giving the party concerned an opportunity to amend (In Soo-Kim v Youg [2011] EWHC 1781 (QB)).*

e) *The court may strike out, as an abuse of the court's process, particulars of claim which are so badly drafted that they fail to reveal to the defendant, or to the court, the case the defendant can expect to meet at trial. However, proof of bad drafting is not, by itself, sufficient. The court should not strike out the particulars without first giving the claimant an opportunity to amend (see In Soo-Kim v Youg [2011] EWHC 1781 (QB)).*

f) *The purpose of the particulars of claim were explained by Moore-Bick LJ in Credit Suisse AG v Arabian Aircraft & Equipment Leasing Co [2014] CP Rep 4:*

> *"Particulars of claim are intended to define the claim bring made. They are a formal document prepared for the purposes of legal proceedings and can be expected to identify with care and precision the case the claimant is putting forward. They must set out the essential allegations of fact on which the claimant relies and which he will seek to prove at trial, but they should also state the nature of the case that is to be made in order to inform the defendant and the court of the basis on which it is said the facts give rise to a right to the remedy being claimed."*

g) *It is not appropriate to strike out a claim in an area of developing jurisprudence, since, in such areas, decisions as to novel points of law should be based on actual findings of fact (Farah v British Airways, The Times, January 26, 2000, CA referring to Barrett v Enfield BC [1989] 3 W.L.R. 83, HL).*"

Advocate Newman also highlighted how I then set out the test at para. 15 of *Jakob International Inc. v HSBC Private Bank (CI) Limited* (unreported, 1 July 2016), having just quoted the same passage: "*the question is whether the Plaintiff's case is unarguable, bound to fail or unwinnable. I regard these terms as interchangeable. The burden of establishing that this is so rests on the Defendant.*"

18. Before leaving the applicable domestic cases on striking out, I note the reference in para. 48 of the *Tranquillity* case to rule 10(2)(a) of the 2007 Rules, which provides that a Cause must contain "*a statement of the material facts on which the plaintiff relies for his claim, but not the evidence by which those facts are to be proved*". This requirement is similar to the content of particulars of claim in England and Wales, which is why the purpose of them given by Moore-Bock LJ in the passage quoted can be regarded as relevant to the consideration of whether a Cause is adequately pleaded.

19. Advocate Newman also refers to the way in which courts in other jurisdictions have recognised that questions as to whether loss was legally caused by an auditor's negligence are particularly unsuitable for striking out. He notes that there is a lengthy section in Chapter 6 of *Accountants' Negligence and Liability* by Salzedo and Singla relating to failed applications to strike out. In particular, he highlights a New Zealand case, *Sew Hoy & Sons Ltd v Coopers & Lybrand* [1996] 1 NZLR 392, in which Thomas J commented as follows (at page 407):

> "*Questions of causation are probably particularly unsuitable for consideration on the basis of the pleading alone. As stated by Sir Anthony Mason CJ in March v E & M H Stramare Pty Ltd (1991) 171 CLR 506, at p 515; "The common law tradition is that what was the cause of a particular occurrence is a question of fact which 'must be determined by applying common sense to the facts of each particular case', in the words of Lord Reid: Stapley [v Gypsum Mines Ltd [1953] AC 663 at p 681]. "A full*

grasp of the facts is imperative. Experience has demonstrated time and again that the answer to the question of whether there is a nexus between the breach of the defendant and the loss suffered by the plaintiff and, if so, what it is, then tends to fall into place. Indeed, if the question whether there is a causal connection between the wrong-doing and the damage is to be resolved by the application of common sense, it is difficult to see how that question properly can be approached in advance of the evidence. Common sense thrives on hard facts, not abstractions."

20. The *Sew Hoy* case was then considered by Cooke J in *MAN Nutzfahrzeuge AG v Freightliner Ltd* [2004] PNLR 19, as being relevant to what was said immediately before turning to this case (in para 39):

> "*In this action, Freightliner say that, unlike in Galoo, there is a plea of loss caused as a result of the failure by the auditors in detecting Mr Ellis' fraud in exactly the same way as if they had failed to detect defalcations which continued after they had given a clean certificate of audit (the Sasea case). This was the very thing that they were to guard against in the course of their audit. In my Judgment, this raises an arguable issue which is not capable of being determined on a summary basis but requires investigation on the facts in order to determine whether it is well founded before applying any principles of causation.*"

21. Both of these decisions were referred to, along with others, in the Isle of Man case, *Heather Capital Limited (in liquidation) v KPMG Audit LLC* (unreported, 17 November 2015), which was also an application to strike out a claim made against auditors. Deemster Corlett dismissed that application because he was satisfied that there was a sufficient pleading of legal causation that went beyond "but for causation" and, if wrong, was satisfied that suitable amendments to the pleading could be made (para. 58).

22. Advocate Swan does not dispute that these cases led to the outcomes that followed in each case, but points out that there are other examples of legal causation being decided summarily, citing *Galoo* as a primary example and on which the Defendant relies. The Defendant's position is effectively a simple one, based on there being a minimum requirement for a properly pleaded case which the Plaintiff's pleading does not satisfy. If that argument is accepted, it follows that the Cause is defective because it discloses no reasonable grounds for seeking the relief it does, and rule 52(2)(a) is satisfied.

No legal causation argument

23. The principle on which the Defendant relies finds its roots in the judgment of Hobhouse J in *Berg Sons & Co Ltd v Adams*. The first plaintiff, by then in liquidation, claimed against its former auditors, alleging breaches of the contractual and tortious duties owed to it by them, which were alleged to have led to some £13 million of losses. The first plaintiff had been wholly owned by a single person. As such, it was accepted factually that the directing mind and will of the company was that person, meaning that his knowledge was the company's knowledge. The passage on which the Defendant relies appears on the top of page 678, but the paragraph in which it is found begins at the bottom of page 677:

> "*In the present case it has not been proved that there was any fraud by Mr Golechha in relation to the 1982 audit, still less that at that time Mr Golechha was practising any fraud upon his principal, Berg. There was no entity which it can be said he misled or in relation to which it can be said that he was acting fraudulently in relation to the audit in October 1982. However one identifies the company, whether it is the head management, or the company in general meeting, it was not misled and no fraud was practised upon it. This is a simple and unsurprising consequence of the*

> *fact that every physical manifestation of the company was Mr Golechha himself. Any company must, in the last resort, if it is to allege that it was fraudulently misled, be able to point to some natural person who was misled by the fraud. That the plaintiffs cannot do.*"

As a result of that requirement in a claim against an auditor to identify some natural person acting on behalf of the company who would have acted differently but for the alleged wrongdoing of the auditor, Advocate Swan submits that it is a pleading requirement to specify at least one such person. There is a further passage from this judgment that is referred to in the *AssetCo* case, but which in full reads: "*Causation cannot be examined independently of the identification of the alleged cause of action; it involves the relationship between the loss or damage suffered by the plaintiff and the fault of the defendant*" (page 682).

24. Within the auditing context, the Defendant turns next to the *Galoo* case. The Court of Appeal in England and Wales affirmed the first instance decision to strike out the statement of claim. Galoo Limited was wholly owned by Gamine Limited. In 1987, Hillsdown Holdings plc purchased 51% of the shares in Gamine. Hillsdown made substantial loans to Galoo and Gamine and in 1991 acquired a further 44.3% of the shares in Gamine. The defendant was the auditor of Galoo from 1981 to 1991 and of Gamine from 1984 to 1991. The plaintiffs' claim related to the audited accounts for the years 1985 to 1989 and the draft accounts for 1990. The case is referred to because of the way in which (as set out in the *AssetCo* case) it distinguished between a breach that can be shown to be the effective legal cause of the loss and one that is merely the occasion of the loss and the way in which Glidewell LJ suggested that the answer to the question as to how the court decides between those two bases is largely through the application of the court's common sense. Interestingly, as summarised at para. 6.06 of Salzedo and Singla:

> "*The claimants had not pleaded that the auditors knew or intended that the accounts should be relied upon by Hillsdown for the purpose of making such loans. It followed that their pleading on this point was inadequate and the Court of Appeal confirmed that it fell to be struck out.*"

25. The Defendant offers the *AssetCo* case as a recent example of the application of the principle derived from the *Berg* case. In doing so, it recognises that the factual situation in that case was different to the facts in the present case. (As Advocate Newman has pointed out, this was also a decision following a trial as distinct from an application to strike out.) Advocate Swan drew attention to the way in which the main points in issue were described in para. 9 as being about causation and loss and referred in particular to the way in which the parties' cases were summarised from para. 26 onwards. I have noted para. 27, which states: "*AssetCo's position is that the true state of the company's affairs would have been discovered in 2009 or 2010 and that events would then have taken essentially the same course as they took when the truth was in fact discovered in 2011 (save that, it says, events would have moved more quickly than in 2011). AssetCo would then have avoided expenditure which it made in 2009 and 2011, which expenditure has, it says, been wholly wasted.*" This is broadly comparable to the case being advanced by the Plaintiff here. In response, the defendant's case on this question was summarised in para. 32(3):

> "*Third, legal causation: GT submits that even if it could in principle be liable to AssetCo in some amount, none of the heads of damage claimed by AssetCo was in the event legally caused by GT. It alleges that those alleged losses result only from the continuation of the existence of the company – and as such they are losses which, GT submits, do not fall within the scope of the auditor's duty to protect against – or because (so it alleges) there was some intervening act which broke the chain of causation.*"

26. Bryan J deals with this legal causation point in section I.4 of his judgment, referring both to the *Berg* and *Galoo* cases, commenting in para. 970 that "*The separate requirement that legal causation is satisfied fulfils the same policy imperative as the requirements of scope of duty and remoteness: it is a way of limiting the responsibility of a party in breach to losses that are sufficiently connected with that party's duty and breach.*" In particular, the Defendant relies on the analysis of the issue of reliance by the plaintiff on the audit undertaken (as covered in section I.4.1).

27. Although Advocate Swan placed particular emphasis on what is set out in para. 977, I will put that comment into its context by quoting several further paragraphs of the judgment of Bryan J:

> "*975. In Berg Sons, the company was not misled by the audit certificate in any way, and so whatever losses may have eventuated were not the consequences of the inaccuracy of the information provided by the auditor and were not recoverable. Those losses were not sufficiently causally connected to the auditor's breach as to render the auditor responsible for ongoing losses, even if it could factually have been said that an accurate audit report might have avoided some of the losses.*
>
> *976. AssetCo submits, citing Salzedo and Singla at [8.48], that "[r]eliance is not, strictly speaking, a necessary component of any [audit negligence] claim, but in practice it may well be essential if factual causation is to be made good. Reliance … is also relevant to the question whether a duty of care is owed by an auditor to a particular claimant".*
>
> *977. I consider that, at least in circumstances such as those of the present case, reliance will ultimately be essential. Indeed the same authors (Salzedo and Singla) also write at [8.141] having reviewed the authorities on whether trading losses can be recovered from a negligent auditor that the "key point to bear in mind" was that made by Hobhouse J in Berg Sons:*
>
> > *"Since the provision of knowledge of the company and its members is the subject matter of the contract, unless it can be shown that the company or its members were in some way misled or left in ignorance of some material fact, the breach of contract lacks significance."*
>
> *A claimant company must show that the relevant decision-making organ of the company was misled by the information supplied by the auditor; a chain of factual causation that does not involve reliance on the audit report by a person to whom the auditor owed a duty of care is unlikely to qualify as a sufficient chain of legal causation.*
>
> *978. AssetCo submits that reliance usually plays a role in cases where the audited company is a "one-man band", where the auditor owes no duty to draw the fraudulent director's fraud or misfeasance to his own attention. It submits that that is the way to understand Berg Sons & Adams [sic], where the sole shareholder – and therefore the company – would not have acted differently if the audit had been conducted competently, and that GT's reliance on Berg Sons & Adams is misguided. In particular, AssetCo distinguishes the position of AssetCo plc, which was not a "one-man band"; it submits that a number of persons at AssetCo relied on GT's work and/or the audited accounts, including the NEDs and the innocent shareholders including NAV, and that the very purpose of the auditor's duty of care is to ensure the*

provision of reliable information to such persons so that they can make decisions about the stewardship of the company.

979. Plainly, it will be relevant in deciding whether there has been reliance on auditors whether a company is a "one-man band". If in the present case Mr Shannon had been the only decision-maker in AssetCo, it would be difficult (if not impossible) for AssetCo to establish that he relied on GT's clean bill of health in the audits, given that he would have known that the accounts were misstated. But I do not see a point of principle there. The ease or difficulty with which reliance may be proven does not alter the fundamental point that AssetCo must show that the losses it claims were factually and legally caused by GT's breach and are recoverable; and in order to do that it must show that the decision-makers at AssetCo relied on GT's audit work.

980. I therefore agree with GT that reliance is in the present case essential. That is so both as a matter of fact and in showing legally that GT's breach of duty was the effective cause and not merely the occasion of each head of loss.

981. However, I emphasise that the question is not only whether the relevant decision-maker in the company has relied on the audit certificate; as Salzedo and Singla note at [8.30] in their discussion of Berg Sons, that decision-maker might also have relied on "the auditor's silence as to fraud". Whether such reliance is made out is a question of fact, and in that regard I agree with Mr Templeman's submission, made by reference to MAN v Freightliner [2005] EWHC 2347 (Comm) at [359], that AssetCo does not need to show reliance in the sense of its board or shareholders subjectively having the audits in their mind when they made decisions, which would be unrealistic; rather it must show reliance in the sense that it would have acted differently but for GT's breach, and in that regard it can point to how it did act when it discovered the fraud (as the Canadian Supreme Court did in Livent at [82] – [84]).

982. In the present case I have already found above in relation to the Counterfactuals (i.e. the question of factual causation) that AssetCo would have acted differently if GT had acted competently, in the respects I have identified (i.e. AssetCo would have restructured and recapitalised the company in broadly the same way as it did in 2011 when the true financial state of the company came to light). In such circumstances I have no difficulty in concluding and finding that subject to any question of intervening acts and the like, the requirement of reliance is satisfied in the present case so far as trading losses are concerned. I consider the position in relation to Jaras payment, dividends and claims arising out of breach of the PSA, separately below."

28. Advocate Swan further submits that the recent Supreme Court decision in the ***Singularis*** case is supportive of the analysis in the ***AssetCo*** case. The factual situation in this case was different, because the claim was against the company's investment bank and broker for breach of the so-called ***Quincecare*** duty of care. However, when delivering the Court's judgment, at para. 36 Lady Hale dealt with one of the arguments raised on behalf of the respondent in which reference was made to auditors' duties:

> "*Daiwa makes two further arguments – essentially policy arguments – against this conclusion. First, it argues that it is odd if the claim of a company arising out of the dishonest activities of its "directing mind and will" against a negligent auditor fails (as in Stone & Rolls and in Berg Sons and Co Ltd v Adams [1993] BCLC 1045) but a claim against a negligent bank or broker succeeds. But (quite apart from the difficulties of Stone & Rolls) this ignores the fact that the duties of auditors are*

different from the duties of banks and brokers. The auditor's duty is to report on the company's accounts to those having a proprietary interest in the company or concerned with its management and control. If the company already knows the true position (as in Berg) then the auditor's negligence does not cause the loss."

29. In relation to an auditor's duty in respect of an entity such as the Plaintiff, Advocate Swan accepts that section 27A of the 1987 Law protecting investors imposes a duty on the auditor to inform the GFSC of certain matters of which it becomes aware. Subsection (2) provides:

> "*It is the duty of any person acting as an auditor to communicate to the Commission matters to which this section applies and which the auditor has reasonable cause to believe is, or is likely to be, of material significance for determining either –*
>
> *(a) whether a person is a fit and proper person to carry on controlled investment business, or*
>
> *(b) whether the Commission should exercise its powers under this Law in order to protect investors from a significant risk of loss.*"

However, he submits that this section does not assist the Plaintiff because the means by which it is enforced are found in section 27B:

> "*If it appears to the Commission that an auditor has failed to comply with a duty imposed on him by section 27A(2), the Commission may report the auditor to any authority, institution or professional body to whose rules or requirements that auditor is subject, and may disclose any information with a view to the institution of disciplinary proceedings, or otherwise for the purposes of such proceedings.*"

As a result, he submits that the imposition of the duty is to assist the regulator and does not amount to a duty in private law. Moreover, the duty only arises where an auditor has reasonable cause to believe what is significant, so it does not exist where what it is said should have been found has not been discovered.

30. In respect of this whistle-blowing duty, Advocate Newman points out that he is unaware of any authority that deals with how this duty operates. Accordingly, it amounts to a novel point of law not suitable for determination on a strike-out application. Further, he refers to para. 12(5) of the Cause, which makes this particular point in respect of the duties and obligations of the Defendant upon which the Plaintiff relies:

> "*In the event that:*
>
> *(a) it identified a fraud or obtained information that indicated that a fraud might exist; or*
>
> *(b) it ought, as a reasonably competent auditor, to have identified a fraud or obtained information that indicated that a fraud might exist; or*
>
> *(c) it suspected, or had reasonable grounds to suspect, a fraud, or irregularities giving rise to a substantial risk of loss to investors;*
>
> *then to report promptly (and without waiting for finalisation of the financial statements) to an appropriate organ of PIF independent of the suspected fraud or irregularity and to the GFSC as PIF's regulator and the body charged with powers to protect investors. Failing the making of such reports, PwC was required to resign*

and report such matters to the members and creditors of PIF in accordance with section 273 of the Companies Law."

31. The reference to section 273 of the Companies (Guernsey) Law, 2008, as amended, refers to the final section in Part XVI of that Law. Given that there is comment in some of the cases before the Court relating to the scope of the statutory duty of an auditor, Advocate Newman also draws attention to section 262:

> "*(1) A company's auditor must make a report to the company's members on all accounts of the company of which copies are, during his tenure of office, to be sent out to members under section 251.*
>
> *(2) The auditor's report shall state whether in the auditor's opinion, the accounts –*
>
> *(a) give a true and fair view,*
>
> *(b) are in accordance with generally accepted accounting principles, and*
>
> *(c) comply with any relevant enactment for the time being in force.*
>
> *(3) The auditor's report must state the name of the auditor and be signed and dated.*"

He points out that the obligation is to report to the company's members, which, in the case of the Plaintiff, includes its preference shareholders. There is no indication in this provision or elsewhere in the Law (eg, Part X) that the members referred to are only those with voting rights. Section 263 requires an auditor to carry out investigation to enable him to form an opinion as to whether proper accounting records have been kept and whether the accounts are in agreement with the accounting records. Subsection (3) states that "*If the auditor fails to obtain all the information and explanations which, to the best of his knowledge and belief, are necessary for the purposes of his audit, he shall state that fact in his report.*"

32. In this context, Advocate Newman also highlights that the Registered Collective Investment Scheme Rules 2008 (and the replacement 2015 Rules) required a registered investment scheme to appoint a qualified auditor as the auditor of the scheme (rule 3.04). He suggests that this was a requirement made under legislation explicitly designed for the protection of investors. He could have referred to section 2A of the 1987 Law as supporting this argument, because the GFSC is required, when carrying out its functions under that Law, to have regard to the objectives *inter alia* of protecting investors, as well as the reputation of the Bailiwick as a financial centre.

33. From this foundation, Advocate Newman further suggests that when considering those to whom the Defendant owed its duties as auditor of the Plaintiff, the members holding preference shares can also be viewed as an organ of the company. Advocate Swan concedes that any member with voting rights is capable of deciding how the company acts and so falls within the class of those who are relevant decision-making organs of the company for the purpose of relying on the audit process, but he distinguishes those who have no voting rights because, even if they receive materials in the form of the auditor's report, they have no decision-making capacity.

34. Although Advocate Swan rejects the suggestion that the proposition on which the Defendant relies from the ***Berg*** and ***AssetCo*** cases runs contrary to what has been said about the ***Stone &***

Rolls case, Advocate Newman continues to contend that the absence from those cases of any principle along the lines now advanced on behalf of the Defendant supports the Plaintiff's view that this is something novel and lacking in support from any authority higher than Bryan J in *AssetCo*. However, because it does not appear to be central to the issue before this Court, I will deal with the arguments fairly briefly.

35. The *Stone & Rolls* case itself turned on illegality in respect of what can be described as a one-man company, rather than being about the legal causation point now raised on behalf of the Defendant. This is apparent from the headnote:

> "*The auditors denied negligence and, on their application for summary judgment or for the claim to be struck out, the judge held that the actions and state of mind of S were to be attributed to the company and that it was artificial to describe the company as the victim of the frauds, but that, since the detection of fraud was the very thing the auditors were engaged to undertake, they were not entitled to rely on that fraud as a defence based on the principle of ex turpi causa non oritur actio, and he refused the application. On the auditor's appeal the Court of Appeal concluded that since the company was to be attributed with responsibility for the fraudulent activities against the banks and had relied on that illegality in its claim against the auditors, any failure by the auditors to detect the frauds, as "the very thing" they were engaged to undertake, could not debar them from relying on the principle of ex turpi causa non oritur actio. They accordingly allowed the auditors' appeal and struck out the company's action. …*
>
> *Held, dismissing the appeal (Lord Scott of Foscote and Lord Mance dissenting), that, since S was the beneficial owner and directing mind and will of the company who, as its human embodiment, exercised exclusive control over it, the exception to the rule of attribution, that it would be unjust to fix the company with the fraudulent intentions of its directors, did not apply; that, therefore, the company was to be imputed with awareness of the fraudulent activities against the banks and was primarily liable for them; that any duty owed by the auditors was to the company as a whole and not to individual shareholders or its creditors; that all whose interests formed the subject of any such duty, namely the company's sole directing mind and will, already knew about and were party to the illegal conduct which formed the basis of the claim; and that, in the circumstances, the auditors could rely on the defence of ex turpi causa to debar the company's claim and the action had properly been struck out.*"

36. As is readily apparent, the issues to be resolved in that case were different from the point made on behalf of the Defendant now. Advocate Newman referred to para. 270 in the speech of Lord Mance (who was in the dissenting minority) as containing a reference to the *Berg* case in which His Lordship touched on the duty of the auditors to report to others: "*I believe it would in any event probably be the auditors' professional and common law duty to report suspicions of fraud to the proper authorities*", and would need to do so "*without informing management in advance, in order to protect the interests of the company*". That paragraph concludes: "*It would be a strange policy and law that exempts auditors from all responsibility to the company, according to the chance that the directors on whose integrity they undertaken to report prove to be the sole "beneficial owners" of all the company's shares.*"

37. This decision was, as Advocate Newman pointed out, subjected to detailed analysis in the *Bilta* case. More recently, it has been subjected to further comment in *Singularis*, and I will confine myself to quoting some paragraphs from the judgment of the Court delivered by Lady Hale, which I believe summarise the position clearly and succinctly:

"*30. Stone & Rolls has prompted much debate and criticism. It was analysed in detail by a panel of seven Justices of this Court in Bilta (UK) Ltd v Nazir (No 2) [2015] UKSC 23; [2016] AC 1. The company and its liquidators brought claims against its directors and others who were alleged to have dishonestly assisted the directors in a conspiracy to defraud the company. The claim was defended on the basis that the fraud of its directors was attributable to the company which could not then make a claim against the other conspirators relying on its own illegality. This court held unanimously that where a company has been the victim of wrongdoing by its directors, the wrongdoing of the directors cannot be attributed to the company as a defence to a claim brought against the directors – and their co-conspirators – by the company's liquidator for the loss suffered by the company as a result of the wrongdoing. The court explained that the key to any question of attribution was always to be found in considerations of the context and the purpose for which the attribution was relevant. Where the purpose was to apportion responsibility between the company and its agents so as to determine their rights and liabilities to one another, the answer might not be the same as where the purpose was to apportion responsibility between the company and a third party.*

31. Stone & Rolls was a case between a company and a third party. Lords Toulson and Hodge, after analysing the judgments in detail, reached the conclusion (para 154) that "it should be regarded as a case which has no majority ratio decidendi. It stands as authority for the point which it decided, namely that on the facts of that case no claim lay against the auditors, but nothing more". Lord Sumption identified three points for which it was authority (para 80). But Lord Neuberger, with whom Lord Clarke and Lord Carnwath agreed, agreed only with two of those three (para 26). The first was that an illegality defence cannot be run by a third party against a company where there are innocent shareholders or directors. The second was that the defence was available, albeit only on some occasions, where there are no innocent directors or shareholders. Lord Mance agreed with the first of these but as to the second he commented that it "appears [to be] a factually correct representation of the outcome of Stone & Rolls, though the present appeal does not raise the correctness in law of that outcome, which one day may fall for consideration" (para 50).

32. Subject to the two points with which he agreed, Lord Neuberger said this:

> *"[T]he time has come in my view for us to hold that the decision in Stone & Rolls should be as Lord Denning MR graphically put it in relation to another case in In re King, decd [1963] Ch 459, 483, be put 'on one side in a pile and marked "not to be looked at again"'. Without disrespect to the thinking and research that went into the reasoning of the five Law Lords in that case, and although persuasive points and observations may be found from each of the individual opinions, it is not in the interests of the future clarity of the law for it to be treated as authoritative or of assistance save as already indicated." (para 30)*

33. Unfortunately, the majority's acceptance of the second point has been treated as if it established a rule of law that the dishonesty of the controlling mind in a "one-man company" could be attributed to the company – with the consequences discussed earlier – whatever the context and purpose of the attribution in question. Thus there was much argument in this case about what was meant by "innocent" directors and whether this included innocent but inactive directors who should have been paying more attention to what Mr Al Sanea was doing. The judge found that Singularis was not a one-man company in the sense that the phrase was used in Stone & Rolls and

Bilta (Rose J, para 212). The company had a board of reputable people and a substantial business. There was no evidence to show that the other directors were involved in or aware of Mr Al Sanea's actions. There was no reason why they should have been complicit in his misappropriation of the money (para 189). The Court of Appeal held that, on those findings, she had made no error of law (CA, para 54).

34. I agree. But in any event, in my view, the judge was correct also to say that "there is no principle of law that in any proceedings where the company is suing a third party for breach of a duty owed to it by that third party, the fraudulent conduct of a director is to be attributed to the company if it is a one-man company". In her view, what emerged from Bilta was that "the answer to any question whether to attribute the knowledge of the fraudulent director to the company is always to be found in consideration of the context and the purpose for which the attribution is relevant" (para 182). I agree and, if that is the guiding principle, then Stone & Rolls can finally be laid to rest."

38. I take the view that the references made to the *Stone & Rolls* decision and what has happened since are of little relevance to the issue I have to decide. I have set it out in this manner because of the way it has been raised by Advocate Newman, but the starting point, in my view, has to be what the position is in Guernsey law and reference to decisions from other jurisdictions can be persuasive as to what that law is. However, this Court is not bound by any of those decisions, and so the nature of their persuasive effect is more open than would be if the case were being heard in England and Wales. As a matter of theory, it is feasible for something contained in a dissenting judgment to resonate as a matter of Guernsey law. What matters is not what the majority view on any point is elsewhere as if it were binding on this Court, although I appreciate that the normal approach is to regard decisions of the highest courts in other jurisdictions as carrying more weight than would, for example, a dissenting judgment in a court lower in that jurisdiction's hierarchy, but the strict approach to decisions in the domestic context does not, in my opinion, apply in the same way when considering what are all persuasive judicial opinions from other jurisdictions. The way in which the parties' contentions have been addressed on this Application have, it seems to me, occasionally verged towards approaching this action as if it were taking place in London. I think that is unfortunate and would only comment that the starting point, where there is no domestic authority, is to consider what the most appropriate solution for Guernsey ought to be. The absence of authority should not automatically mean that Counsel turn, without more ado, to what the position would be in England.

39. In the present case, being an action in negligence (for this purpose, but not ignoring that it is also a case in contract), this Court will generally have regard to the position in English law. Although the Advocates did not refer to it, this follows from what was said in *Morton v Paint* (1996) 21.GLJ.61 ("*Guernsey law, in adopting the English law rules in the field of tortious liability*"), but, of course, this relates to the substantive law rather than to any procedural rules. Put at its simplest, the Defendant advances the principle derived from the *Berg* case, as illustrated by the decision in *AssetCo*, as meaning that there is a requirement in Guernsey law that for a claim against an auditor to succeed a plaintiff must be able to show that there is some natural person acting on behalf of the company who would have acted differently in his or her capacity as an organ of the company so as to put the company in a better financial position. If that contention is correct, then the next issue becomes whether or not this is a case in which the Cause should be struck out. If that contention is not the position as a matter of Guernsey law, recognising that the burden lies on the Defendant, then the Application (on this ground) will fail.

40. As Advocate Newman has pointed out, for the purposes of this Application, the Cause is taken at its highest. Accordingly, it follows that the Plaintiff's case that it was the victim of a

massive fraud under which the majority of the money subscribed by its preference shareholders was stolen from it has been made out. Further, it follows that the Defendant was in breach of its duties as auditor and that, had it performed its duties as a competent auditor, the fraud against the company would have been reported by no later than 11 May 2015. Against that background, the first consideration will be the scope of the duties owed by the Defendant as auditor to those to whom the Defendant was obliged to report.

41. Comparatively little was said about this issue. To an extent, there was common ground that the position set out in *Caparo Industries plc v Dickman* operates. Advocate Newman referred to the way Lord Oliver of Aylmerton endorsed how the statutory duty of the auditors was summarised by O'Connor LJ as follows (at page 653):

> "*The statutory duty owed by auditors to shareholders is, I think, a duty owed to them as a body. I appreciate that it is difficult to see how the over-statement of the accounts can cause damage to the shareholders as a body; it will be the underlying reasons for the over-statement which cause damage, for example fraudulent abstraction of assets by directors or servants, but such loss is recoverable by the company. I am anxious to limit the present case to deciding whether the statutory duty operates to protect the individual shareholder as a potential buyer of further shares. If I am wrong in thinking that under the statute no duty is owed to shareholders as individuals, then I think the duty must be confined to transactions in which the shareholder can only participate because he is a shareholder. The Companies Act 1985 imposes a duty to shareholders as a class and the duty should not extend to an individual save as a member of the class in respect of some class activity. Buying shares in a company is not such an activity.*"

His Lordship then added (at page 654):

> "*In my judgment, accordingly, the purpose for which the auditors' certificate is made and published is that of providing those entitled to receive the report with information to enable them to exercise in conjunction those powers which their respective proprietary interests confer upon them and not for the purposes of individual speculation with a view to profit. The same considerations as limit the existence of a duty of care also, in my judgment, limit the scope of the duty and I agree with O'Connor L.J. that the duty of care is one owed to the shareholders as a body and not to individual shareholders.*"

42. In similar vein, Lord Bridge of Harwich (at page 625) quoted the summary of the position given by Bingham LJ, in which emphasis was placed on the various provisions in the Act setting out what happens to the auditor's report, which reflect the provisions of the 2008 Law, before adding (at page 626):

> "*No doubt these provisions establish a relationship between the auditors and the shareholders of a company on which the shareholder is entitled to rely for the protection of his interest. But the crucial question concerns the extent of the shareholder's interest which the auditor has a duty to protect. The shareholders of a company have a collective interest in the company's proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy. But in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself and any loss suffered by the shareholders, e.g. by the negligent*

> *failure of the auditor to discover and expose a misappropriation of funds by a director of the company, will be recouped by a claim against the auditors in the name of the company, not by individual shareholders.*"

As further noted at para. 6.12 of Salzedo and Singla's work: "*The narrowness of the general audit duty as determined in Caparo is now well-known and increasingly the cases which are argued or reported concern the circumstances in which an auditor will be found to have assumed responsibility for purposes over and above the statutory purpose, rather than attempts by claimants to assert that the auditor owed additional duties simply as auditor.*"

43. In the context of the audit work in respect of a closed-ended investment fund, there is an additional layer of responsibility placed on the auditor. There are the general statutory duties found in the 2008 Law, to which this line of authority from *Caparo* can be applied, but there is also the duty for the scheme to be audited under what was, at the time, the 2008 Rules. The context and purpose of the 1987 Law and the Rules made thereunder are very much to protect investors. Accordingly, this is an area where it appears to me that the scope of the duties may well not be as clear as they would be for a non-regulated company because it is uncertain whether there ought to be any gloss added to the *Caparo* line of authority as it will operate in respect of such a fund. Further, the question of whether the enforcement provision in section 27B of the 1987 Law makes any difference is yet to be resolved. Either way, the obligations imposed on an auditor to report findings to the GFSC as regulator may show that the principle found in the *Berg* and *AssetCo* cases should not be applied to a situation like this at face value.

44. I have, therefore, paid close attention to the way the principle relied upon by the Defendant is being advanced. It really amounts to a pleading point. Based on the approach described in the *AssetCo* case, what is being suggested is that the Plaintiff is required to make good its case by pleading who the relevant decision-making organ (or possibly multiple organs) of the Plaintiff company is who was misled by the failure to spot the fraud being perpetrated and who would have acted differently if that information had been given (ie, a slight modification of how it is put at para. 977, read with para. 981, of Bryan J's judgment). This is the reliance issue and Advocate Newman's submissions about para. 981 showing this is a question of fact do not assist if I find that this legal principle means that the identity of that person or those persons is a material fact that must be pleaded in accordance with rule 10 of the 2007 Rules.

45. If I assume for present purposes that the position as set out in the *AssetCo* case represents the current state of English law on the issue of reliance, it follows that it will most likely be the position in Guernsey law. In other words, it will be the case that it is an essential element of the Plaintiff's action that it must show reliance, being that at least one relevant decision-making organ was misled by the silence of the Defendant in relation to the fraud. As such, it necessarily follows that the identity of the person who relied in this manner becomes a material fact and so has to be pleaded in accordance with rule 10 of the 2007 Rules. This is really putting the Defendant's case at its highest and I have chosen to take this as the basis on which to determine the Application because, if the Defendant's case were actually to be analysed more closely, there are comments even in the judgment of Bryan J (eg, at para. 981) which demonstrate that the focus ought to be on who would have acted differently, which arguably puts any pleading obligation in a different light.

46. The Defendant's case was raised at para. 16.2 of the Defences and Counterclaim as follows:

> "*In the premises, PIF has failed to allege, and in any event it is not the case, that any reliance was placed on PwC's audit report by a person to whom the auditor owed a duty of care and who, in their capacity as an organ of the company, would have acted differently if not for such reliance.*"

The Plaintiff answers this contention at para. 15(a) and (b) of its Réplique and Defence to Counterclaim:

> "*(a) The relevance of the allegation is denied in circumstances where legal causation does not require the facts alleged to be established.*
>
> *(b) In any event, it is denied that no reliance was placed on PwC's audit report or its failure positively to report the fraud by a person to whom the auditor owed a duty of care and who would have acted differently if not for such reliance: PwC owed a duty to the company for the general body of shareholders, including preference shareholders; had PwC not breached its duties, the managers and/or directors who were not dishonest participants in the fraud or, alternatively, the preference shareholders themselves, would have taken appropriate action, including by alerting the GFSC.*"

Paragraph (a) does not assist the Plaintiff if the position in law is reflected by what Bryan J set out in the *AssetCo* case and any pleading referring to "*the managers and/or directors who were not dishonest participants in the fraud*" is likely to result in a request for further information as to who those persons are. Equally, though, para. 3(c) of the Réplique and Defence to Counterclaim, responding to para. 4 of the Defences, states:

> "*For the avoidance of doubt, PIF does not allege that its Guernsey-based directors and management were dishonest participants in the fraud, including Paul Everitt, Ian Roger Parry, Robin Fuller, Stephen Dewsnip and Adam Tattersall.*"

Accordingly, taking the pleading as a whole, it seems that there has been an indication of several persons by name in respect of whom the Plaintiff will seek to prove that there was no dishonest participation and so in respect of whom it can be inferred there has been reliance on the duty owed by the Defendant. It may not be explicit, but it appears to me that the Defendant knows the case it has to prepare to oppose in respect of the directors.

47. The Plaintiff's position, though, has not been assisted by what it then pleaded at para. 5 of its Duplique to Réplique to Defences to Counterclaim ("*it is denied that PIF is required to plead and prove that any particular natural person involved in PIF's governance was innocent of the alleged fraud in order to prove its case*") and the way it has dealt with the issue in correspondence. It could comparatively easily have cross-referred to those about whom it had already pleaded that there was no allegation of dishonest participation as being those who relied on the Defendant performing its functions competently, in which case this part of the Application would not have been capable of being pursued. However, even proceeding on the basis that the Defendant has persuaded me that the law of Guernsey requires a pleading of reliance, I would not strike out the Cause for this reason.

48. The first basis on which I decline to strike out the Cause is that, as I have already described it, this is a pleading point. Where a pleading is defective and can be remedied by being re-pleaded, the approach is to refrain from striking out the action because that opportunity to re-plead should be given. Whilst I appreciate the submission made on behalf of the Defendant by Advocate Swan that such an invitation has been given to the Plaintiff's Advocates and rejected, it would, in my judgment, run contrary to the overall set of principles applied by this Court to end what is otherwise an action capable of being pursued without now giving the Plaintiff that opportunity. This is not an action that is unwinnable or bound to fail if the defect in the pleading can be rectified by amendment. If there is to be any sanction, that can sound in costs rather than depriving the Plaintiff of its ability to pursue its case, especially where the case is clearly for the benefit of others, such as the investors.

49. The way in which the pleading of the claim is to be refined is, of course, a matter for the Plaintiff. However, because the issue of whether those innocent preference shareholders could be regarded as capable of forming what Bryan J in the ***AssetCo*** case described as the relevant decision-making organ of the company has been aired, I will offer my provisional view on that question. I recognise the strength of Advocate Swan's submission that, in the absence of voting rights, these preference shareholders cannot be said to have any means by which to take decisions on behalf of the Plaintiff. However, I further noted what was said by the Supreme Court at para. 36 of the ***Singularis*** case that "*the auditor's duty is to report on the company's accounts to those having a proprietary interest in the company or concerned with its management and control*". The distinction between those who manage or control a company and those with no more than a proprietary interest, which I consider extends to those with preference shareholdings, may well mean that what the Plaintiff has already pleaded in para. 15(b) of its Réplique and Defence to Counterclaim is sufficient. There is also the position in relation to the duty under the 1987 Law to alert the GFSC to matters of concern. Further, there is the point made by Bryan J at para. 981 of his judgment that what potentially matters in a case of silence is who would have acted differently had something been said. In that regard, I consider that there is an argument that those persons who invested as preference shareholders not knowing about the fraud would not have done so if the fraud had been reported.

50. Both of these points bring me to the second basis on which I would, in any event, reject the no legal causation argument of the Defendant as a reason to strike out the Cause, which is that, in my judgment, it is inappropriate to do so in an area of developing jurisprudence without basing that conclusion on actual findings of fact. I would have been slightly hesitant about basing my conclusion solely on this reason because the Court of Appeal has previously indicated that where a position is clear in English law, and Guernsey law will follow that position, this Court should accept as much and not regard an area as being a developing one, even in the absence of any previous Guernsey decision. However, it seems to me that the position in English law may well not be applied without some form of gloss to an auditor's duty to a regulated entity where there is a requirement to have the scheme of the fund audited. In such a case, the protection of investors and the role of the GFSC as regulator are areas where I consider reaching conclusions based on a full appreciation of the factual matrix is more appropriate than attempting to determine the case summarily by way of this Application to strike out. Where Counsel have been unable to even refer to any previous case of auditor's duties in Guernsey, it could be said that whatever the result, it will be a novel point of law domestically. When that position is compounded by issues that could, at least as far as I can tell from the pleaded cases, become relevant to the scope of the duties owed and the way in which reliance is, or is not a factor, I remain unconvinced that the strike out jurisdiction should be exercised in those circumstances. Although it is of less significance, the fact that I was told that the ***AssetCo*** case is being appealed may mean that the state of English law, and so Guernsey law adopting the English law position, develops further (or is clarified), which has also had a bearing on my decision.

51. For these reasons, I will dismiss the Application so far as it is based on the no legal causation argument. However, in doing so, I will also invite the Plaintiff to consider whether, either by way of some amendment to its pleadings or by way of the provision of further information akin to answering a rule 60 application, it can assist sooner rather than later in spelling out for the benefit of the Defendant how it is putting its case on reliance in the event it becomes an issue. I do so on the basis of actively encouraging the parties to identify those areas of dispute so as to prepare themselves for the case they have to meet, and in this instance particularly for the Defendant to know that aspect of the Plaintiff's case.

No loss argument

52. The second limb of the Defendant's Application is less complex. In summary, it is critical of para. 140 of the Cause because it refers both to money received and disbursed, meaning that there is a net neutral position and so no loss. With no pleading of any loss, it follows that the action is bound to fail.

53. Advocate Newman meets this contention by reference to the analysis of this type of argument by Bryan J in some later paragraphs in the judgment given in the ***AssetCo*** case, culminating in what is set out in para. 1085. It is submitted that any wrongdoer claiming credit for a benefit of the wrong committed has to establish that that wrong has to be the legal as well as the factual cause of the benefit (para. 1057). As such, the Defendant would have to show, by reference to the common sense overall judgment derived from other cases, such as ***Galoo***, the sufficiency of the causal nexus between breach and benefit. Even if both limbs can be satisfied, referring to what Popplewell J had said at first instance in ***The New Flamenco*** [2017] 1 WLR 2581 (as quoted by Lord Clarke in the Supreme Court), "*considerations of justice, fairness and public policy have a role to play and may preclude a defendant from reducing his liability by reference to some types of benefits or in some circumstances even where the causation test is satisfied*" (para. 1062).

54. As Advocate Newman further notes, the issue of whether the raising of capital by a share placing was a benefit to the company had been raised and expert evidence had been adduced. However, this was not something that Bryan J needed to resolve in light of his other conclusions, making it an academic point and one which he thought it preferable to leave open for a case in which it mattered (para. 1081). Accordingly, although this is the area where the Australian case on which the Defendant relies (***Pilmer v Duke Group Limited***) was cited in support, as it has been again in the present case, Advocate Newman submits that this shows it is an area where the principle has not yet been resolved and so is unsuitable to be determined on a strike-out application. He also suggests that the approach articulated on behalf of AssetCo in that case that there are strong policy reasons why a company should not be required to give credit to the auditors for capital raised and subsequently lost led to Bryan J concluding (at para. 1085):

> "*This is not a claim by the shareholders/investors qua investors. It is a claim by the company for losses that it in fact suffered and that it would not have suffered had its auditors performed their duty properly. If required to give credit for the capital raised, this would, submits AssetCo create a "gap" in that the company could only recover in respect of sums already held at the date of the audit opinion despite establishing factual and legal causation in respect of the loss of the subsequently raised sums. It is said that there is no principled reason why that should be the case. And that the contrary is true. It is a readily foreseeable consequence of a breach of an auditor's duty – particularly regarding the duty to detect fraud – that the company via (dishonest) management will continue to suck in capital which will be wasted on precisely the same fraudulent or imprudent ventures as should have been uncovered by the audit. To find that the loss of that capital on precisely those ventures is irrecoverable because credit must be given for the capital influx in the first place, would be an unwarranted reduction on the scope of the auditor's duty.*"

55. The Defendant's Advocates point out that this apparent reliance on the conclusion of Bryan J represents an abandonment on behalf of the Plaintiff of what is pleaded at para. 18 of its Réplique and Defences to Counterclaim ("*Specifically, it is denied that PIF's receipt of such a sum constituted a benefit. Even upon receipt, the benefit was balanced by the liability to repay and as the money subscribed was lost through the continuance of the fraud, the obligation to repay became a liability which PIF was without assets to meet.*") They distinguish the factual position in the ***AssetCo*** case, in which the share placement was to raise

capital needed for the ordinary course of business (as shown in para. 1069), whereas the Plaintiff's case is that its previous management ran the company as a Ponzi scheme, where any obligation to repay investors is not equivalent to where there is a debt but instead amounts to an investment upon which a return is hoped to be derived.

56. There is some attraction to the simple argument advanced on behalf of the Defendant. Looking at para. 140 of the Cause in isolation, the loss claimed in the final sentence is that "*PIF would then have avoided the loss of £14,012,730.38 in investors' money received and disbursed after 11 May 2015.*" The combination of "*received and disbursed*" as set out in this short-hand format does appear to advance a net neutral position, which means that there is no loss. However, if that is the case, then Advocate Newman seeks the opportunity to re-plead the case.

57. I do not, though, think that the simplicity of that submission is the full answer to this issue. The first sentence in para. 140 uses words that are then repeated in the alternative basis on which loss and damage is pleaded in para. 141, in which it is said what "*the losses that would have been avoided had PwC discharged its duties and obligations to PIF, such that PIF ultimately would have ceased to accept further subscriptions and collected in all its assets*", following which there is a table showing the number of preference shares issued after various dates, being the ends of the months following 11 May 2015. The implication is that the first element of what follows from the breaches alleged against the Defendant is the continuing receipt of subscription monies for the preference shares. This is really the equivalent of "sucking in capital" which will then be wasted under the fraud being continued, as described by Bryan J. The reference to "*and disbursed*" in para. 140 makes it sound as though there was legitimate expenditure, when the underlying premise of the action is that this was how monies that were lawfully the Plaintiff's came to be lost (or "stolen", adopting the words of Advocate Newman).

58. The issue of whether this is a situation in which the Plaintiff is required to give the type of credit mentioned in the cases considered by Bryan J in the ***AssetCo*** case is not, in my judgment, one that can be said to be settled. There is both the general aspect of whether the law of Guernsey reflects the position argued in that case, but not resolved, and whether, because this arises in the context of preference shares under the statutory regime of the 1987 Law and subordinate legislation, in which the protection of those investors plays a part, there is something more particular that needs some refinement of those principles. Accordingly, I find that it would be unjust if the Plaintiff were now to be denied the chance of pursuing its claim because of the way in which it has articulated its alleged losses and damage. If I had to do so, I would fall back on the considerations of justice, fairness or public policy that enter into play to conclude that the Cause should not be struck out.

59. In any event, because of the principles applied to a strike-out application, I would afford the Plaintiff the opportunity to set out its claimed losses in another way or I would find that the inter-relationship of the receipt of subscription monies and the way in which they were diverted from the use to which they were expected to be put are matters that can only be determined after a trial. As a matter of Guernsey law, I am not persuaded that this can be said to be anything other than an area of developing jurisprudence, in which any legal principles should be based on actual findings of fact. These are reasons why it is, in my judgment, inappropriate to grant the Defendant's Application.

60. Although Advocate Newman relied on ***Sasea Finance Ltd (in liquidation) v KPMG*** [2000] 1 All ER 676 in relation to the no legal causation argument, I have noted that it also contains some comment that resonates with me on this no loss issue. In the headnote, it states:

> "*Where a company's auditors discovered that a senior employee had been defrauding the company on a massive scale, and that employee was in a position to continue doing so, the auditors would normally have a duty to report the discovery to the management immediately, not merely when rendering their report. Moreover, if the auditors suspected that the management might be involved in, or was condoning fraud or other irregularities, the duty to report overrode the duty of confidentiality, and the auditors would have to report directly to a third party without the management's knowledge or consent. The relevant considerations would include the extent to which the fraud or other irregularity was likely to result in material gain or loss for any person or was likely to affect a large number of persons, and the extent to which non-disclosure would enable the fraud or irregularity to be repeated in the future. In the instant case, there was a sufficiently pleaded case that losses incurred after 28 September 2000 might have been avoided if KPMG had taken some sort of action to 'blow the whistle'. Moreover, if was impossible to say that SFL had no arguable case in relation to the efficacy of such whistle-blowing. Furthermore, no distinction was to be drawn between the four transactions as pleaded. Each was the kind of transaction against the risk of which KPMG had a duty to warn.*"

The facts are, of course, different. There, there were four transactions set out, whereas in the present case, there is only reference to the total number of preferences shares involved without any details. However, the overall approach bears a high degree of similarity to the position in the action before this Court. In giving the judgment of the English Court of Appeal, Kennedy LJ quoted (at page 682) what Lord Hoffmann had said in *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191, 211 in relation to the scope of the duty owed being the starting point for calculating the damages to which a plaintiff is entitled as compensation for loss, before adding:

> "*It is accepted for present purposes that it was KPMG's duty to warn either the directors or some relevant party of any fraud or irregularity likely to result in material loss to the company with a reasonable degree of promptitude. Why should that be? The obvious and commonsense answer is that by doing so the company may be spared such losses.*"

61. For the purposes of this Application, the pleaded case is to be taken at its highest. This means that consideration of what losses were sustained flows from there having been the fraud found and the breach of duty owed established. Although there will inevitably be argument as to what consequences flowed from the Defendant not reporting the fraud that was apparent (at least in this scenario), I find it impossible to conclude that the Plaintiff has an unwinnable case that some loss arises, which might extend to the upper limit set out in para. 140 of the Cause. Because it has an arguable case on loss, this is not a plain and obvious case in which striking out the action should follow.

62. I have further considered whether what is pleaded is already sufficient or whether I should invite the Plaintiff to clarify how it is putting its case. I fear that the problem lies in the brevity in para. 140 of combining receipts and disbursements without more detail. In other words, I come back to the simplicity of the net neutral position argument deployed by Advocate Swan. At face value, that does appear to be the suggestion from the words used, although I strongly suspect that the Defendant knows exactly the case being advanced on behalf of the Plaintiff and which it has to meet. However, if only to put the issue that has been raised beyond further question, if the Plaintiff's Advocates can expand upon what is pleaded in para. 140 (and perhaps also para. 141) so as to explain in more detail what its case is in respect of the compensation it claims should be payable by the Defendant, that will probably assist. This is particularly so where para. 18 of its Réplique and Defences to

Counterclaim may need to be re-visited anyway and where I have similarly afforded the Plaintiff's Advocates the chance to re-visit its pleaded case on the no legal causation point.

Conclusion

63. For all the reasons that I have given, the Defendant's Application to strike out the Cause and bring these proceedings to an end is dismissed.

64. I do, however, take the view that these were reasonable points for the Defendant to raise. They arise because of the way in which the Cause has been pleaded and, as I have indicated, if the Plaintiff wishes to re-visit these two aspects (ie, the no legal causation and no loss arguments) before the action proceeds to the case management conference, it should do so. However, I have not been persuaded that either argument has sufficient force that the action should be terminated on the basis of that argument. In particular, although the points were properly raised on behalf of the Defendant in correspondence, they could always be addressed by affording the Plaintiff the opportunity to seek to amend the pleadings. It was the Plaintiff's Advocate's unwillingness to do so that has resulted in the Application being brought on as it has, although I do think that the no legal causation argument could well have been tackled, at least first, by a further request for information. In any event, the principles that will attach to an auditor's duties in the context of an action involving funds, because of the additional factor of the 1987 Law and subordinate legislation thereunder, makes this a novel area for determination in Guernsey and so would, on that basis, have led to the conclusion that the Application fell to be dismissed.