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Update

Jetivia v Bilta: Illegality defence dismissed in the Supreme Court

The Supreme Court has handed down the much anticipated decision in the matter of *Jetivia SA and another v Bilta (UK) Limited and others* [2015].

Arising out of an application for strike out, the Appeal was unanimously dismissed by the seven Justices. In so doing, the Court upheld the decision of the Chancellor of the High Court, Sir Andrew Morritt, and the subsequent decision of the Court of Appeal.

The case caused the Supreme Court to look critically at the interaction between (i) the law of attribution and (ii) the scope of the doctrine known as "*ex turpi causa non oritur actio*", or, put another way, the doctrine which holds that a party will be unable to pursue a legal remedy if it arises in connection with his own illegal act, also known as the "illegality defence". The key question for the Supreme Court was: when the directors of a company involve their company in a fraudulent transaction, is the company barred (by virtue of the *ex turpi* doctrine) from suing those directors and their accessories for losses caused by their breach of fiduciary duty?

In short, the Supreme Court said "no": dishonest directors (and their associates) cannot rely on their own wrongdoing to escape liability, on the basis that the acts of such directors cannot be attributed to the company.

We might have hoped that this decision was going to provide practical guidance on the *ex turpi* doctrine and the law of attribution, but in truth this is a case which is really quite confined on the facts.

Background facts

Bilta (UK) Limited is an English company which was ordered to be wound up by the High Court on 29 November 2009 on the application of HMRC. Proceedings were brought by Bilta (through its liquidators) against two former directors and a Swiss company, Jetivia SA.

The Appeal, which was heard on 14 and 15 October 2014, arose out of a preliminary issue on the pleadings as between Bilta on the one hand and Jetivia on the other.

In summary, Bilta's pleaded allegation was that, between April and July 2009, the two directors caused Bilta to engage in fraudulent trading. As a result of the fraud, it was alleged that Bilta had a claim for damages against the directors. The directors maintained in response that Bilta was, through its directors and shareholders, party to the illegality, which precluded it from pursuing the claim.

The Judgment

The Court unanimously held that the illegality defence could not bar Bilta's claims against the directors on the basis that the conduct of the directors could not be attributed to the company in the context of a claim against the directors for a breach of their duties.

Whilst there was unanimity in the decision, it is clear from the judgments (of Lords Neuberger, Mance, Sumption, Toulson and Hodge) that the reasoning of each was not always aligned.

Reasons for the Judgment

Attribution

The law presumes that the acts and state of mind of a company's directors and agents can be attributed to the company by application of the law of agency. The Court focussed heavily on this point, specifically whether the acts of the fraudulent director could (or should) be attributed to the company.

Although their approaches differed, Lords Sumption, Toulson and Hodge agreed that, as Lord Neuberger put it: "*where a company has been the victim of wrong-doing by its directors, or of which its directors had notice, then the wrong-doing, 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*".

This was the case for claims in which the loss suffered by the company was "*as a result of the wrong-doing, even where the directors were the only directors and shareholders of the company, and even though the wrong-doing or knowledge of the directors may be attributed to the company in many other types of proceedings*".

Lord Mance observed that the question as to attribution must be determined with reference to the "nature and factual context of the claim in question".

The illegality defence

The Court acknowledged that the approach which should be adopted to a defence of illegality is both difficult and important. With that in mind, Lord Neuberger, together with Lords Clarke, Carnwath and Mance, felt that there was a genuine need for the Supreme Court to review the matter in detail. They felt, however, that this case did not present the appropriate opportunity.

Citing (approvingly) Lord Mansfield CJ in *Holman v Johnson* (1775), a case concerning two highwaymen who sought an account of their partnership profits, Lord Sumption remarked that the "simple" illegality defence has been amongst "*the most heavily litigated rules of common law, and by the end of the twentieth century it had become encrusted with an incoherent mass of inconsistent authority*".

Of significant interest are the differing views of Lord Toulson and Lord Hodge, on the one hand, and Lord Sumption on the other. It is quite clear that Lord Sumption regards the defence of illegality as a rule of law, independent of any judicial value judgment about the balance of the equities in each case, which is in contrast to Lords Toulson and Hodge, whose joint judgement focusses on public policy arguments.

Suing a third party

Lord Sumption devoted a number of paragraphs to the situation which may arise when a company sues a third party who was not involved in the directors' breach of duty for an indemnity against its consequences. He observed that "*for a person, whether natural or corporate, who is culpable of fraud to say to an innocent but negligent outsider that he should have stopped him in his dishonest enterprise is as clear a case for the application of the illegality defence as one could have*".

In so doing, Lord Sumption reaffirmed the existing jurisprudence concerning such claims, but the law is, of course, more developed in relation to innocent third parties whose duty it is to identify fraud but who fail to do so through their own negligence.

Comment

This decision will not come as a surprise. It would seem wrong as a matter of common sense to attribute the knowledge of a fraudulent director to a company, which thereby allows that director to avoid liability for the losses the company suffers as a result.

Perhaps reflecting Lord Sumption's observations concerning the unsatisfactory development of the law in this area, Lord Neuberger suggested that the illegality defence should be addressed by not only seven Justices but "*conceivably with a panel of nine Justices as soon as appropriately possible*". It may be some time before an appropriate case works its way up to the Supreme Court, such that these issues can be dealt with decisively.

Nevertheless this decision does usefully explore the historic case law that has arisen on the vexed issues of attribution and the nature and scope of the illegality defence and it provides a very helpful platform for future judicial analysis.

It is clear that the Court was also keen to take the opportunity to have *Stone & Rolls v Moore Stephens* [2009] put into its proper, and very limited, context – in that case, of course, the House of Lords allowed the *ex turpi* defence where a claim was being brought against a third party by the company, rather than against the fraudulent directors themselves. Lord Neuberger observed that "*it is very hard to seek to derive much in the way of reliable principle from the decision of the House of Lords in Stone & Rolls*", before going on to describe it (using Lord Denning's words) as a case to be "*put on one side and marked 'not to be looked at again'*"!

Further information

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