Cooley

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Introduction

Companies are habitually used as part of a corruption scheme. Such companies often have only a single director, or a small number of directors, and are beneficially owned by the wrong-doers.

Insolvency powers can be effective tools to obtain compensation for victims of fraud or corruption, in the right circumstances.

A state could, for example, apply to Court for a liquidator to be appointed over a company used for corruption.

Amongst other things, a liquidator is entitled to bring claims against the company's former directors for their wrongdoing in involving the company in a corruption scheme. Claims can also be made against third parties dishonestly assisting with or participating in that wrongdoing. The intention is to repatriate recoveries to the victim state (subject, of course, to the rights of any other creditors).

A liquidator's claim against directors could be based on breaches of the obligations ("fiduciary duties") they owe to act in the best interests of the company. Involving the company in criminal conduct, or other wrongdoing, is plainly a breach of those duties. There are various others claims that might be available, including the powers of an insolvency court to require those knowingly participating in fraud to contribute to the debts of the company.

The effectiveness and availability of the insolvency powers has been confirmed and emphasised by the much anticipated decision of the UK Supreme Court in *Jetivia SA & Anor v Bilta (UK) Ltd (In Liquidation)* & Others.

The Court decided:

- Directors could not defeat a claim by liquidators on the basis that the wrongdoing of the directors should be attributed to the company, even where all directors and shareholders had knowingly participated in the wrong-doing. It therefore rejected the directors' argument that the company was itself a "wrongdoer" and unable to sue its former directors because of the English law principle that a claimant cannot rely on its own illegal actions to make a claim.
- The English Courts have power to require fraudulent foreign defendants to contribute to the debts of an insolvent company.

However, the Court also emphasised that victims remain entitled to make a claim against a company that has been used to receive or launder the proceeds of corruption or fraud. In those circumstances, the acts of the directors are attributable to the company they have caused to be involved in wrongdoing.

The Facts

Bilta (UK) Ltd (**"Bilta"**) was compulsorily wound up in November 2009. Its liquidators brought proceedings against (among others) its two former directors, a Swiss company, Jetivia SA (Jetivia), and Jetivia's chief executive, Mr Brunschweiler.

The claim was based on a fraudulent "carousel" scheme seeking to defraud the UK tax authorities.

The liquidators alleged that the directors caused Bilta:

- to enter into a series of transactions with Jetivia, and others, to buy and sell carbon credits;

- to purchase credits from entities outside the UK (and therefore free from VAT),
- to sell those credits to UK entities inclusive of VAT (but at a price net of VAT which was slightly lower than it had purchased them for)
- to direct most of the sales money due to Bilta to be paid to other parties (including Jetivia).

The transactions created an obligation on Bilta to account to HMRC for output VAT and an obligation on HMRC to pay a slightly lower sum by way of input VAT to another company.

HMRC paid the input tax. However, Bilta was (and was, it is alleged, always intended to be) insolvent and unable to pay the output VAT, amounting to £38 million.

The Claim

The liquidators brought claims against the directors for conspiracy, breach of duty and fraudulent trading. The claims against Jetivia and Mr Brunschweiler were for dishonest assistance in the director's breaches of duty.

The liquidators further sought directly from each of the four defendants a contribution under section 213 of the Insolvency Act 1986 (IA 1986), which provides as follows:

> (1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.
>
> (2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.

The Appeals

The directors argued that, as their actions are attributable to the company itself, Bilta was itself guilty of the very wrongdoing on which the claim was based. This meant, they argued, the claims should be dismissed. If the claims against the directors were unavailable, claims would also not be possible against a third party like Jetivia.

The appellants further contended that section 213 of the Insolvency Act did not have extra-territorial effect. As the appellants were a company incorporated in Switzerland and its director who was domiciled in France, they were not subject to the statutory provision.

The Judgment of the Supreme Court

The defendants' arguments had failed before a Judge, and also in the Court of Appeal. The Supreme Court, comprising a panel of seven Judges, unanimously dismissed the appeal and upheld the decisions of the lower courts, although on various grounds.

With regard to the issue of attribution, Lord Neuberger (with whom Lords Clarke and Carnwath agreed) summarised the conclusions of Lords Sumption, Toulson and Hodge as follows:

"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, for the loss suffered by the company as a result

of the wrong-doing, even where the directors were the only directors and shareholders of the company…"

Lord Neuberger further suggested that this principle should not be limited to cases of fraud: it is not so much an exception to a general rule; it is an exception to the agency-based rules of attribution, which is *"based on public policy – or common sense, rationality and justice".* Agreeing with the judgment of Lord Mance, he noted that:

"...whether or not it is appropriate to attribute an action by, or a state of mind of, a company director or agent to the company or the agent's principal in relation to a particular claim against the company or the principal must depend on the nature and factual context of the claim in question."

This means both that a company can sue its fraudulent directors, and also that victims can sue a company that has defrauded them, even where the company is acting under the direction of, say, a sole director and shareholder.

The Supreme Court also dismissed the argument that fraudulent foreign defendants could not be required to contribute to the debts of an insolvent company, with Lord Sumption describing it as *"misconceived".*

As a matter of English law, a winding up order is of world-wide effect. Further, the legislation permitted the Courts to require *"any [qualifying] person"* to contribute to the debts. The Court decided that the phrase *"any person"* – should bear its literal and natural meaning and not be limited to persons within the UK (upholding the Court of Appeal's judgment in *Re Paramount Airways* [1993] Ch 223).

Comment

There has been some concern following the decision in *Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm)* [2009] UKHL 39, that a fraudulent sole director (or a fraudulent group of directors acting together) might be able to defeat a claim brought by a company or its liquidators based on an argument that the wrongdoing should be attributed to the company.

In Stone & Rolls, the liquidators of an insolvent company made a claim against the company's auditors for failing to identify a fraud carried out by the company's sole director and shareholder. The case failed on the basis that the liquidators were seeking to rely on the company's own illegal actions.

For those seeking to identify and claim proper redress from the actual wrongdoers in cases of fraud in which a company has been used as a pawn, *Bilta* is an important decision. It demonstrates that Stone & Rolls has only limited scope and does not prevent a company from suing directors that used it for fraud.

More generally, the law of illegality is widely considered to be confusing and complex. In giving their judgments, Lords Sumption, Toulson and Hodge commented on the proper approach to the illegality defence. However, Lord Neuberger concluded that it would be *"unwise to seek to decide [the principle] in this case where it was not determinative of the outcome and where there has been little if any argument on the topic".* He added, however, the proper approach to the defence of illegality *"needs to be addressed by* [the Supreme Court] … *as soon as appropriately possible".*

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