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Case No: CL-2015-000733

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 26/10/2018

Before :

MR JUSTICE JACOBS

- -

Between :

Adam Anderson and others	**Claimants**
- and -	
Sense Network Limited	**Defendant**

- -
- -

Gerard McMeel and Jay Jagasia (instructed by **Cubism Law**) for the Claimants
Simon Howarth (instructed by **Reynolds, Porter, Chamberlain LLP**) for the Defendant

Hearing dates: 02/07/2018 – 05/07/2018, 09/07/2018 – 12/07/2018, 16/07/2018 – 18/07/2018, 24/07/2018 - 25/07/2018

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

MR JUSTICE JACOBS

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MR JUSTICE JACOBS:

A: The facts and the claims in outline

1. In this action, 95 Claimants allege that they were the victims of a fraudulent "Ponzi" scheme ("the scheme"). The scheme was masterminded by Mr. Alistair Greig ("Mr. Greig"), who owned and ran a company called Midas Financial Solutions (Scotland) Limited ("MFSS" or, as it was frequently referred to in the course of the trial, "Midas"). MFSS was a financial advisory business based in Aberdeen. It was a continuation of a scheme that Mr. Greig had operated when he had previously worked for a financial advisory firm known as Park Row Associates Ltd ("Park Row"). It continued after Mr. Greig founded MFSS in 2006. Crucially, it continued at all material times after September 2007, when MFSS became an "Appointed Representative" ("AR") of the Defendant in this case, Sense Network Ltd. ("Sense"). The question in this case is whether Sense is liable for the losses suffered by the Claimants.

2. The essence of the scheme was that individuals (or "investors"), most of whom were resident in Scotland and in particular in the Aberdeen area, were offered the opportunity to receive high guaranteed interest rates on short-term deposits. The deposits were made by the investors giving cheques (and in one case, cash) to Mr. Greig or one of the financial advisers who worked for MFSS. These cheques were not made payable to MFSS, but rather to a name such as "Midas Aberdeen" or "Midas Financial".

3. When the deposit reached maturity, the investors would receive or be credited with interest and this would encourage their confidence in the scheme. They would frequently decide to roll over the deposit for a further period, and in many cases invest further funds. Investors who wanted to be repaid their deposits as well as interest were indeed repaid for many years, up until the collapse of the scheme in 2014. They would receive cheques which were not drawn on the account of MFSS, but rather on an account designated "Midas Financial – Aberdeen" which was an account at the Royal Bank of Scotland ("RBS") operated by Mr. Greig.

4. In reality, the interest that was paid, and any capital returned, was not the product of successful investment whether by Mr. Greig or RBS, whose alleged involvement in the scheme had been described to many of the investors. Instead, as with any Ponzi scheme, Mr. Greig was simply making payment from funds subscribed by participants in the scheme. The scheme could continue as long as Mr. Greig, or the advisers at MFSS, could find investors who were willing to subscribe new funds to the scheme, or to leave their existing monies in the scheme. The amounts of money involved in the scheme were very significant. During the period 2010 to 2014, the total credit turnover on the "Midas Financial – Aberdeen" RBS account exceeded £ 27 million. During the same period, the total debit turnover on the account exceeded £ 26.6 million.

5. In August 2014, however, the whistle on the scheme was blown by Mr Keith Ingram, an employee of and financial adviser at MFSS. He provided information about the scheme to Sense. At the time he did so, he was not aware that the scheme was a Ponzi scheme, with no real underlying investment or arrangement with RBS. Rather, he was aware that Mr. Greig should not have been operating the scheme without the knowledge of Sense, and he had become concerned about developments in relation to a different scheme with which this case was not concerned.

6. Mr. Ingram's information led to a raid on MFSS's offices by the Financial Conduct Authority ("the FCA") and the police. It also led to enforcement action by the FCA in September 2014. The FCA petitioned the Court of Session in Edinburgh for a number of interdictions against MFSS and Mr. Greig, and these were granted by the Lord Ordinary. The FCA alleged that MFSS and Mr. Greig had acted in breach of section 19 of the Financial Services and Markets Act 2000 ("FSMA") by carrying out a regulated activity, namely the accepting of deposits, without being authorised to do so, in breach of the general prohibition under section 19 FSMA. The correctness of that allegation has not been in dispute in these proceedings, and has been amply proven by the evidence in this case.

7. At the time of the enforcement action, according to the FCA's petition, there was approximately £ 379,000 remaining in the "Midas Financial – Aberdeen" RBS account. There were, however, some 279 members of the public who had investments in the scheme. They had deposited £ 12.8 million and were owed £ 13.6 million upon the maturity of their investments. The money remaining was manifestly insufficient to repay them.

8. Mr. Greig now faces criminal prosecution in Scotland. There was no dispute in these proceedings that Mr. Greig was operating a dishonest Ponzi scheme. The Claimants have lost very substantial sums of money, and the issue in these proceedings is whether these losses can be recovered from Sense. It is not alleged that any of the senior management or indeed any employees of Sense had any knowledge of the scheme. Indeed, the evidence is clear that it was successfully concealed from Sense over the 7 years that the relationship of principal and AR existed between Sense and MFSS. Sense's senior management therefore only learned about the scheme in August 2014 from Mr. Ingram, and they then took immediate action to terminate the relationship with MFSS.

9. The Claimants allege that Sense is liable for their losses as a result of a number (five or six, depending upon how they are analysed) of different legal routes. Most of these routes (namely, the claims based on (i) s.39 of FSMA, (ii) actual or apparent authority, (iii) the attribution of Mr. Ingram's knowledge to Sense in relation to a claim of breach of Sense's supervisory duties, and (iv) vicarious liability) do not involve any allegations of fault or wrongdoing by the management of Sense. However, the Claimants also allege two routes which do involve fault by Sense. They allege that there was a failure by Sense adequately to monitor MFSS. They also allege that there was a failure by Sense properly to investigate certain matters which came to their attention during the course of the relationship. The most significant of these matters concerned information received about Mr. Greig and two other MFSS financial advisers from Accord Mortgages ("Accord"), a mortgage provider within the Yorkshire Building Society. The Claimants contend that a proper investigation would have afforded Sense a golden opportunity to identify the lack of integrity of Mr. Greig and other financial advisers.

10. Sense's case is that none of the Claimants' routes to liability should succeed. If successful, however, Sense alleges that there should be a reduction in the quantum of any liability for the Claimants' contributory negligence.

B: The trial and the witnesses

11. The parties' respective cases, and the different legal theories advanced, meant that there was extensive factual evidence at the trial. This covered, in particular, the circumstances in which the Claimants came to invest in the scheme and the amounts lost; the way in which the scheme was operated at MFSS, and why Sense did not find out about it; the steps taken by Sense to monitor and supervise MFSS; Sense's reaction to various problems which came to their attention, and in particular the information received from Accord; and the work and role of Mr. Ingram and others who worked at MFSS.

12. On the Claimants' side, I heard oral evidence from a large number of individuals, principally the "Lead Claimants", who had invested in the scheme. At the first Costs and Case Management Conference in November 2016, it was ordered that the claim should be managed and tried by reference to Lead Claimants, and that the claims of all claimants other than the Lead Claimants should be stayed pending resolution of the claims of the Lead Claimants. These witnesses were Mr. Donald Ross; Mr. Michael Lee; Mrs. Jacquelyn Liddell; Mrs. Julie Baylis; Mr. Norman Masson; Mr. Mark Ansell; Mr. Brian MacKenzie; Mr. Graham Hudson; Mr. Myles Creighton and his wife Mrs. Morag Creighton; Mr. Alexander Lucas; Mrs. Lynne Hutchinson; Mr. Kevin Rognaldsen; and Ms. Alison Shepherd. All of these individuals, apart from Mr. Hudson, were "Lead Claimants".

13. The Lead Claimants had been selected by reference to various criteria such as "Claimants who assert that they made deposits into the Scheme in Cash", "Claimants who received cheques from the Midas Financial Aberdeen bank account", and "Claimants with family connections to Midas 'advisers'". As the trial progressed, however, it became clear that the various identified criteria were of no real significance in relation to the parties' arguments: for example, neither party suggested that claimants who made cash deposits (Mr. and Mrs. Creighton being the relevant Lead Claimants in that regard) were in a different position to those who gave cheques. In closing argument, the Claimants' position was that, save in relation to one point, all the Lead Claimants were in a similar position, so that their claims would either succeed or fail as a whole. The one exception concerned the Claimants' argument based on apparent authority, where Mr. McMeel accepted that some of the Lead Claimants (in particular those who frankly admitted that they had never heard of Sense) were not in a position to claim that they relied on a representation by Sense.

14. By the time of closing submissions Sense too drew few distinctions between the different Claimants, and broadly accepted, with two exceptions and leaving aside issues of quantum, that their claims stood or fell together. The two exceptions were (i) apparent authority, where it was common ground that it was necessary to look at each Lead Claimant's claim of reliance separately, and (ii) contributory negligence, where Sense contended that some Lead Claimants were more responsible for their losses than others.

15. Generally speaking, I considered that all of the above individuals sought to give honest and reliable evidence to the best of their recollection. They were usually speaking of events which had occurred many years ago, and it is not surprising that there were occasions when they were inaccurate or were unable to supply detail. Save in relation to Mr. Lucas, the evidence of the witnesses did not appear to be significantly coloured by the arguments in the litigation. Indeed, it was striking that a number of the Lead

Claimants acknowledged that they had never heard of Sense (which led to the case on apparent authority being abandoned in relation to those witnesses). I did not think, however, that Mrs. Liddell gave accurate or reliable evidence in relation to the amounts which she had invested or withdrawn from the scheme: see Section O below.

16. The Claimants also called a number of individuals who worked at MFSS at the material time. The most important witness in that respect was Mr. Keith Ingram. I also heard from Mr. Grant Robertson; Mrs. Judith Greig, the estranged wife of Mr. Greig; Mrs. Christine Dowall; and Mr. William Cutler. Mr. Robertson, Mrs. Greig and Mrs. Dowall all worked in administrative roles at MFSS. Mr. Cutler (who is neither a Lead Claimant nor indeed a claimant) was a financial adviser at MFSS, and he and his sister were also investors in the scheme – in fact they invested a substantial amount of the money inherited from their mother. The Claimants also called Mrs. Sally Waddingham of Accord.

17. Again, generally speaking, I thought that these witnesses sought to give honest evidence to the best of their recollection. I was not, however, persuaded by the evidence of Mrs. Dowall that the scheme would have been revealed to Sense if only Sense had asked appropriate questions. I should make it clear, however, that although all of the above witnesses who worked for MFSS knew about the scheme (Mr. Ingram, Mr. Robertson, Mrs. Greig, Mrs. Dowall and Mr. Cutler), it was not suggested that any of them knew that it was a Ponzi scheme, and there is no evidence that they did. On the contrary, they all appear to have believed that it was a scheme which was legitimate, in that it was genuinely successful at generating substantial funds.

18. Sense called a number of factual witnesses who formed part of their senior management. Their principal witness was Mr. John Netting, who was cross-examined for over two days. He was an honest and impressive witness, who gave direct and fair answers to the many questions which he was asked. I also considered that he was both knowledgeable and generally conscientious in the way that he carried out his business activities. I also heard from Mrs. Leanne Williams, Mr. Adam Owen and Mr. Stephen Young. They were cross-examined much more briefly, and it did not seem to me that there was any significant challenge to any of their factual evidence. Again, they answered the questions directly and clearly, and I see no reason not to accept their evidence (although in the event neither party referred to much of their evidence in their closing submissions).

19. In addition to the evidence given orally, I read a number of witness statements served by the Claimants. These did not add materially to the evidence given by the live witnesses. Sense served written evidence from Mr. Tim Newman, one of the founders of Sense but unfortunately too ill to attend trial. Again, I did not think that his evidence added materially to the evidence, including the expert evidence, that I heard at trial.

20. Each side called an expert witness in relation to financial services and compliance: Mr. Rory Percival for Sense and Mr. David Morrey for the Claimants. My views in relation to those witnesses are set out in the context of my discussion of the issues to which the expert evidence relates: see Section L below.

C: The relationship between Sense and MFSS

21. The present case concerns two separate businesses, linked by the relationship of a principal (Sense) and an AR (MFSS) which became part of the Sense "network" of ARs. As described in more detail below, the Financial Services Act 1986 and now FSMA provide for such relationships and their legal consequences. Broadly speaking, the principal in the network (here Sense) holds the regulatory permissions: i.e. the authorisation from the FCA or (previously) the Financial Services Authority ("FSA"). The individual firms underneath the principal have their obligations to the regulator monitored and supervised and covered by the umbrella arrangement that is the network.

22. Financial intermediary networks have grown over the years. Sometimes these networks are very large: the largest currently has approximately 3,500 individual financial advisers. When Sense started its network in 2007, it was a relatively small network consisting of 4 firms with 30 financial advisers. At that time, 10 of those advisers were at MFSS. By August 2014, it had grown substantially and was a medium-sized network, comprising 74 firms with 184 financial advisers, of which 11 were MFSS advisers.

23. As explained by Sense's expert witness, Mr. Percival, networks have an appeal because if there is a smaller firm with a limited number of advisers, it may be difficult for them get direct authorisation from the regulator. The financial services industry is of course highly regulated, and "compliance" is of considerable importance. "Compliance" in the context of this industry essentially means compliance with external rules imposed by the regulator, as well as compliance with internal rules and regulations (i.e. internal systems of control) developed by the regulated firm in order to comply with those regulations. Because of its size, a smaller firm would not typically have the resources to employ a full-time or part-time person responsible for compliance. In that situation, one option would be to use external sources such as compliance consultancy firms. The other option would be to join a network where, as Mr. Percival explained, "it was all covered for them". They would pay fees in order to have that coverage.

24. Sense was founded by Mr. John Netting and Mr. Tim Newman in February 2007. Their aim was to be a network of professional financial planning firms which would benefit from certain regulatory changes at that time. They believed that there was a market opportunity for a smaller network which focused on working with professional financial advisers.

25. Prior to founding MFSS, Mr. Greig had been the manager of the Aberdeen branch of Park Row. He had known Mr. Netting and Mr. Newman. The former was the Compliance Director of Park Row Group, and the latter was an executive director of Park Row.

26. Mr. Greig and a large number of his colleagues left Park Row to start MFSS, which was incorporated in August 2006. At the outset, MFSS was directly regulated by the FSA, having received authorisation in November 2006. But after discussions with Sense, it was agreed that MFSS would become an AR of Sense and an "Appointed Representative Agreement" ("ARA") was signed on 27 September 2007, approximately 5 months after Sense had itself received authorisation from the FSA. In February 2013 Sense and MFSS entered into a new ARA.

27. The terms of the ARA are material to the case advanced by the Claimants, and it is convenient to set out the relevant terms at this stage. These are taken from the 2013 ARA, which was in materially the same terms as the 2007 ARA.

28. The Explanatory Introduction to the agreement described the scope of the ARA in the following terms:

> This Agreement is part of a set of documents that govern your relationship with the Company. There are also documents for registering Registered Individuals with the Company, procedures for their transfer if they leave you etc… By entering into this Agreement you agree to ensure that you, your Staff and Registered Individuals contracted to you abide by the Agreement and all Company procedures. In addition to this Agreement, the Financial Services and Markets Act 2000 ("the Act") governs our relationship and particularly section 39 of the Act.
>
> By signing this Agreement you (the AR) agree to act as the appointed representative of the Company, in relation to providing financial advice to Customers.
>
> When performing your obligations under this Agreement you agree to comply with the terms of this Agreement, all regulatory requirements and the Company's Compliance Manual.
>
> **What is the scope of this Agreement?**
>
> This Agreement distinguishes between the different kinds of business that you and your Registered Individuals may carry out, which are as follows. The meaning of words beginning with a capital letter is given in the definition section of the Agreement.

29. The kinds of business identified included:

> **Designated Investment Services.** This means advising and arranging in relation to a range of investments regulated under the Act and as indicated by you when you joined the Company. Designated Investment Services may only be carried out by a Registered Individual.
>
> You are not allowed under the terms of the Agreement and the Compliance Manual to provide advice to customers in relation to certain transactions, including pension drawdowns and pension transfers without first obtaining the written approval of the Company
>
> **Personal Protection Insurance Services** …
>
> **General Insurance Services** …
>
> **Mortgage Services** …

> **Additional Services.** This means providing a service of a kind that is often provided by an independent financial adviser other than in relation to Designated Investment and/or Personal Protection Insurance Services and/or General Insurance Services and Mortgage Services.

30. The Explanatory Introduction went on to provide

> **How is Commission handled?**
>
> All Commissions and fees in respect of business which is or should be transacted through a Company Agency is paid to and received by the Company. If you receive a fee for your services instead of Commission, you must declare it to the Company.

31. Clause 1 of the ARA set out various definitions, to some extent repeating or reflecting the description in the Explanatory Introduction. These included:

> 'Additional Service' means providing or offering or agreeing to provide a service of a kind that is often provided by an independent financial adviser other than in relation to Designated Investment and/or Personal Protection Insurance Services and/or General Insurance Services and Mortgage Services.
>
> 'Authorised Product' means those products, policies or services comprising Designated Investment Services … which the AR and its Registered Individuals are authorised to sell or advise on as notified in the Letter of Authorisation provided by the Company.
>
> 'Client Money' means money which is subject to the client money rules as set out in Chapter 9 of the Conduct of Business Sourcebook of the FSA Rules.
>
> 'Company Agency' means an agency which the Company maintains or has maintained with an institution.
>
> "Designated Investment Service" means (a) advising a Customer … on a Specified Investment; (b) making arrangements for a Customer to acquire or dispose of a Specified Investment; (c) agreeing to do either of these.

32. Clause 3 of the ARA, headed 'Appointment' provided as follows:

> 3.1 Subject to clause 2, and in particular subject to the scope of the AR's authorisation as set out in the Letter of Authorisation regarding Authorised Products and the provision of Services, the Company:
>
> 3.1.1 authorises the AR acting through its Registered Individuals to sell and advise on Authorised Products and to provide

> Designated Investment Services, Personal Protection Insurance Services, General Insurance Services, and/or Mortgage Services using a Company Agency; and/or
>
> 3.1.2 authorises the AR acting through its Registered Individuals to provide Additional Services using a Company Agency;
>
> …
>
> 3.5 The AR shall when performing its, and shall procure that its Staff shall when performing their, obligations under this Agreement comply with:
>
> 3.5.1 Legislation and Rules
>
> 3.5.2 the Compliance Manual
>
> 3.5.3 the SCD;
>
> 3.5.4 this Agreement; and
>
> 3.5.3 any instruction issued from time to time by a Regulator and/or the Company in relation to the business which is the subject matter of this Agreement.
>
> 3.6 The AR shall promptly notify the Company of any breach, or suspected breach, of any of clauses 3.5.1 to 3.5.5 by it or its Staff.

33. Clause 4 contained the obligations of Sense. These included permitting Sense to carry out the business set out in Clause 3.1, and to "provide the AR with templates of standard documentation for use by the AR". Clause 4.2 provided:

> The Company accepts responsibility to third parties only to the extent required by Section 39 of the Act in relation to the actions of the AR when the AR is carrying out regulated activities on the terms of this Agreement.

34. Clause 4 also addressed various aspects of the steps that Sense could take to seek to ensure that MFSS was compliant with the regulatory regime:

> 4.5 The Company may provide telephone based support during normal business hours to answer questions concerning compliance matters, and matters related to Services generally.
>
> 4.6 As part of the compliance regime, the Company may provide an initial advisory visit to the AR to ascertain and assess the compliance expertise of the AR.
>
> 4.7 As part of its business monitoring activities, the Company may from time to time visit the AR in order to audit the AR's

> procedures, client care and business activities. Reasonable advance notice … will be given to the AR by the Company.

35. Clause 5 contained various obligations of MFSS.

> 5.1 The AR shall carry out all business dealings
>
> 5.1.1 in relation to Designated Investment Services as an Appointed Representative of the Company and only through and using Company Agencies
>
> …
>
> 5.1.5 in relation to Additional Services, as an agent of the Company and only through and using Company Agencies
>
> …
>
> 5.3 The AR shall not while this Agreement is in force
>
> 5.3.3 act or purport to act outside the scope of its actual authority under this Agreement.
>
> 5.3.6 accept or hold Client Money.
>
> 5.3.7 accept any monies or remuneration in any form that should be paid to the Company or any Customer… Neither the Company nor the AR is allowed to handle monies in any form that might be construed as Client Money…
>
> …
>
> 5.5 The AR shall comply with the Company standards for stationery as from time to time in force. The AR shall use the template documents including terms of business/ initial disclosure document as issued from time to time by the Company when conducting its business with Customers and shall follow the Company's procedures in relation to fact-finds, know your customer and acting in the best interests of Customers at all times…

36. Clause 5 also addressed various aspects of compliance, for example:

> 5.8 The AR shall make the Compliance Manual readily available to its entire Staff.
>
> 5.9 The AR shall notify the Company immediately of any complaint that it receives in accordance with the procedures in the Compliance Manual and co-operate with the Company in handling it.

> 5.10 The AR shall ensure that its Registered Individuals attend any training and sit any examination that the Company (acting reasonably) may from time to time deem necessary.
>
> 5.23 In addition to the obligations set out above, the AR shall:
>
> 5.23.1 maintain sufficient books of account and records relating to the Services carried on under this Agreement to:
>
> 5.23.1.1 show and explain the AR's transactions.
>
> 5.23.1.3 show at any time that it has complied with the requirements of the Legislation and Rules
>
> 5.23.5 co-operate and comply freely and fully with the Company, FSA and the FOS during the engagement as Appointed Representative and thereafter, in the monitoring or investigation of any matters relating to business undertaken by the AR on the Company's behalf or for the Company's benefit.

37. Clause 8 provided for Termination, and gave Sense an entitlement to terminate if Sense had reasonable grounds to believe that "a regulatory or compliance breach requires immediate termination of this Agreement".

38. The prohibition in Clause 5.3.6 of the AR Agreement on accepting or holding "Client Money" was replicated in the MFSS terms and conditions of business that were used pursuant to Clause 5.3.7 and which had been approved by Sense. These terms and conditions were issued to and signed by those clients conducting investment business with MFSS. Those terms specifically informed the client, under the heading "Client Money" (that text being in bold and underlined) that MFSS was *"not permitted to handle client money and we cannot accept a cheque made out to us (unless it is in respect of an item for which we have sent you an invoice) or handle cash"*. (A number of the Lead Claimants in these proceedings received and signed those terms and conditions, namely Mr. Lee, Mrs. Baylis, Mr. Mackenzie, Mrs. Shepherd and Mr. Lucas. They received them because they were receiving advice from MFSS in relation to what might be described as "ordinary" products such as mortgages or pensions. Those claimants who only dealt with MFSS in relation to the Scheme did not receive the standard terms and conditions).

39. At the time that the ARA was signed in 2007, there were 10 financial advisers at MFSS. This grew to 18 in 2008 and 2009. The numbers then dropped back so that in September 2012 there were 10.

40. The advisers who featured in the events relevant to the issues in the trial included Mr. David Laing, Ms. Sandra Thompson, Mr. Allan Milne, Mr. John Ross, Mr. Kevin Alexander, Mr. Ian Towe, Mr. John Cutler and Mr. Jonathan Knowles. Mr. Knowles's position as an adviser was terminated in 2012, and the circumstances of the events leading to his termination were relied upon by the Claimants as part of their case on inadequate supervision: see Section M below. Mr. Kevin Alexander was also

terminated in 2012, although he continued (unbeknown to Sense) to come into the office from time to time and to carry out work for Mr. Greig, and he also continued to promote the scheme. Mr. Keith Ingram became an adviser in 2010, although (notwithstanding that he was not an adviser) he had prior to that time promoted the scheme.

D: Introduction to Sense's oversight and supervision of MFSS and the concealment of the scheme

41. A section of the Explanatory Introduction to ARA, headed "Our regulatory relationship", gives a useful summary of Sense's regulatory responsibilities in relation to the monitoring and supervision of MFSS:

> **Our regulatory relationship**
>
> When you enter into this Agreement with us to become part of the Company, you become our Appointed Representative. This means that you qualify as an 'exempted person' under the Act and may carry on regulated activities as detailed in the letter of authorisation which will be sent to you by the Company. Therefore we have regulatory responsibility under the Act for certain of your activities and we undertake to use reasonable endeavours to monitor and supervise your regulated business activities and act as your compliance department. You undertake to co-operate and to accept our role as your principal and supervisor and agree to ensure that you, your Staff and agents remain compliant within the prevailing regulatory regime. As the Company is accountable for regulating your activities in the conduct of Designated Investment Business we take on major responsibilities. These responsibilities will entail us reviewing your activities including the advice you give and the business you have written. For our services in this respect, the AR will be charged a Fee and Retention (see SCD) and for other Optional Services not covered by the standard Fee, a separate fee shall be charged (see SCD).
>
> There have been sweeping FSA reviews of advice given in respect of certain financial products … The Regulator, in response to public demand, has demanded wide-ranging and costly investigations of advice and Client Files to ensure that consumer confidence in the financial markets is not lost due to mis-selling.
>
> To meet the Regulators' demands on us, we have reserved powers to investigate Client Files and advice given by you both before you join the Company and whilst you are contracted to the Company…

> In the Agreement you undertake to ensure that you, your staff and Registered Individuals co-operate with us to ensure that prior business and Company Agency business is written to the standards required by the Regulator.

42. Thus, Clause 3.5 of the ARA obliged MFSS to comply with (and to procure that its Staff complied with) "Legislation and Rules", which were defined as "legislation, statutory instruments and the rules and regulations of the Regulators and any codes from time to time adopted by the Company that relate to the performance of the AR's obligations under this Agreement, or to the regulation of the Company, including but not limited to the FSA rules." That clause also obliged MFSS to comply with "the Compliance Manual". This was defined as:

> … the document called the Compliance Manual that also incorporates the training and competence scheme, AR manual and any other compliance related document issued and updated by the Company from time to time that sets out the compliance and regulatory requirements including but not limited to approval of Appointed Representatives and Registered Individuals, training and competence, file reviews, business monitoring and audits, AR and Registered Individual suspension, discipline, appeals and relationships with Regulators, all as from time to time amended by the Company

43. Sense's Compliance Manual and other rules and procedures such as its training and competence scheme were available to its ARs on the Sense intranet, an electronic platform. There are statutory rules, described in more detail below, which require a principal to supervise and oversee the AR firm. In broad terms, Sense needed to take steps to ensure that its AR firms and individual advisers were acting in a way which was compliant with regulatory rules. The ARA obliged MFSS to comply with these procedures, and (as explained in the Explanatory Introduction quoted above) Sense became MFSS's "compliance department". Sense therefore needed to, and did, develop its own internal systems of control designed to achieve compliance with external rules, and indeed Sense's own procedures.

44. When Mr. Netting and Mr. Newman started Sense and its network, they wanted Sense to have a single back office computer system so as to ensure that they had a single method of conducting business and a comprehensive record of all business conducted. Accordingly, the firms within the network would not be permitted to select and use their own systems. Mr. Netting and Mr. Newman also wanted to use a computer system which incorporated the ability to hold images of all advice documentation. Most financial advice networks at that time relied upon paper systems and were experiencing problems in locating hard copy files to deal with complaints or to conduct reviews of business written.

45. Sense selected a cloud based system known as "Intelligent Office" ("I/O"). This was a mature system in use amongst a number of advisory businesses. It incorporated document imaging which would allow Sense to deploy it in multiple geographical locations across the proposed AR membership. It would also allow Sense, or a third

party outsourcer, to have access at all times to the AR's client records and advice files and to carry out checks. I/O also had compliance functionality built into the system, including management information reporting tools which would assist Sense in operating its compliance regime. This functionality included the ability to select files for checking according to risk based criteria, and it allowed Sense to match payments received to client/ advice records, and store details of products taken out against client records.

46. Sense also decided to use the services of a third-party compliance consultant on an outsourcing basis for certain core compliance functions. The company selected was threesixty Services LLP ("threesixty"). The I/O system meant that threesixty could conduct file reviews remotely. In the early years of Sense's business, threesixty performed these file reviews, but after 2013 Sense did this work with their own staff.

47. Another early decision, also implemented and reflected in the terms of the ARA, was that all commissions and fees would be sent to Sense's bank account. These could and would be reconciled to records of advice provided by Sense's ARs. This was to be achieved by Sense insisting that all business was written through product provider agencies owned and operated by Sense. Thus, for example, a mortgage provider such as Santander or RBS would have an agency relationship with Sense, rather than with the AR firm itself. As described above, the ARA provided that ARs could only deal with product providers where such an agency relationship (defined as 'Company Agency') existed.

48. Sense's oversight of the activities of MFSS, and indeed other advisers in the Sense network, was carried out by a number of means. A principal control comprised what were described at the trial as "file reviews". These were analyses of the files and other information which had been uploaded to or entered in the I/O system. The I/O system contained standard form template documentation which advisers could use. In addition, all advisers were required to upload all advice documents to the I/O document management system. Through the use of I/O, Sense had constant access to its ARs' client records and files, and was able to carry out detailed checks of activities and individual client files. I/O could generate a range of management information reports through which Sense (and threesixty where appropriate) was able, for example, to provide Key Performance Indicators for supervisory activities; to select advice files upon which threesixty (or Sense after 2013) would carry out remote file reviews; and to conduct reviews of past business as required without the knowledge or involvement of Sense's AR.

49. The file reviews conducted by threesixty, and subsequently Sense itself, involved an examination by the reviewer as to whether the advice provided a suitable outcome for the customer; whether the adviser had met the requirements of the all the relevant FSA/ FCA Conduct of Business rules; and whether the file properly described the story of the advice, so that a clear rationale was evident so as to assist in examining any future complaint.

50. A significant percentage of files were reviewed by threesixty and Sense. Generally, around 30% or more of an AR's files would be reviewed. In the case of MFSS, this was slightly lower at around 25%. This reflected the fact that much of MFSS's business was mortgage advice, which was perceived to be lower risk than investment advice.

51. The files which were on the I/O system were therefore the product of the work carried out by each individual adviser. That adviser was responsible for dealing with the client, including gathering relevant information and doing the necessary research. The adviser might use a "paraplanner" to help produce some of the documentation or perform other back office tasks. But it was the adviser's responsibility to ensure that all relevant information was within the files on I/O. The decision as to which files were to be checked was a matter for threesixty and Sense, and an adviser would not be told in advance which files were going to be the subject of Sense's review.

52. After the review had been carried out, threesixty/Sense would provide feedback to the individual adviser. The feedback would also include any remedial action (known as "remedials") which the adviser was required to take. Remedials could include, for example: making an additional file note; supplying something that was missing; amending a letter before it was sent to a client; writing an addendum letter to the client; revisiting the client and gathering further information; or going to a provider and gathering further information. There was therefore a variety of potential remedials depending upon what the file review had revealed.

53. Between 2007 and 2012, the results of these reviews were shared with Mr. Keith Ingram, who during those dates had the role of Training and Competence ("T&C") Supervisor within Sense. The role of Mr. Ingram is crucial in this case, and is addressed further below.

54. The file reviews were not the only method by which Sense oversaw the activities of MFSS. Other steps included annual audits including analysis of MFSS's bank account. None of the work that Sense carried out, however – whether in relation to file reviews or otherwise – revealed the existence of the scheme. The reason for this was that Mr. Greig and many others at MFSS took steps to ensure that it was not revealed to Sense.

55. Thus, no documents in connection with the scheme, or which even mentioned the scheme in terms which have enabled its nature to be deduced, were uploaded to I/O. All of MFSS's advisers understood Sense's procedures and the importance attached to those procedures. In particular, the system was such that if the procedures were not followed, the advisers would not get paid; because all commissions and fees were to be sent to Sense's bank account. In addition, a failure to follow procedures could be identified on a file review, leading to the need for a "remedial" and, if the remedial remained outstanding, the imposition of sanctions on advisers. The evidence before me established clearly that the reason why there was no uploading of any scheme documentation to I/O was because there was an understanding among advisers and administrative staff at MFSS that the scheme was not to be revealed to Sense. Mr. Ingram said in evidence that information relating to the scheme was "removed from the financial advice process", and that everybody knew that nothing even alluding to it should go on I/O.

56. The documentation at MFSS relating to the scheme was sparse. It essentially consisted of copies of the letters which were sent to the investors (and described in more detail below) and which confirmed the deposits and the amounts payable at the maturity date. These copy letters were given to Mr. Greig, who prior to 2013 used to carry a black briefcase in which he kept a number of these copy letters. From about 2013 onwards, the letters were contained in a lever arch file kept in Mr. Greig's office. Mrs. Dowall also prepared a spreadsheet which she kept on her computer and which comprised a

record of the deposits. There was also evidence that at least one adviser, Mr. Alexander, made his own list of the deposits made by the clients that he had introduced, and it is possible that others may have done so as well. None of this documentation was, however, shown to or seen by Sense's representatives whether as part of their regular annual audit or otherwise.

57. Nor could the scheme be detected by examination of MFSS's bank account. This was because payments by and to investors were not made into or out of the MFSS bank account. They were made to and from the "Midas Financial Aberdeen" account of Mr. Greig.

E: The investors' payments into the scheme

58. The circumstances of the investors' investment in the scheme is relevant to a number of issues in the case, both on liability (in particular the issues of apparent authority and also certain aspects of the argument relating to FSMA s.39) and quantum including contributory negligence. It is therefore appropriate at this stage to describe at this stage the way in which the investments were made. Each witness had a different story to tell as to what led them to invest in the scheme. This is not surprising since the witnesses had invested at different times, and as a result of statements made by different individuals or salesmen within the MFSS organisation. There were however common themes to their evidence.

59. In some cases, the investment had come about after an investor already had an established relationship with an individual at MFSS in relation to a different type of product (for example a pension or an insurance policy). In other cases, an investor was told about the scheme by a friend or relation who had such a relationship, or who had successfully invested in the scheme. In all cases, the investors considered that they were dealing with reputable professional financial advisers and trusted what they were told.

60. The investor was attracted to the scheme as a way of making a substantially greater return than was generally on offer from interest-bearing accounts offered by high street banks. Some investors were more curious than others as to how Midas could offer such advantageous rates. Where explanations were given, they were along the lines that the money was being used by RBS on profitable trading activities, or profitable bridging loans, and that these could generate returns enabling RBS to pay high rates. Some investors were concerned about the security of their money, and a number of investor witnesses were given assurances that the money was protected by the Financial Services Compensation Scheme ("FSCS"); a scheme set up pursuant to FSMA and funded by a levy on authorised firms. The general picture can be illustrated by the evidence of two of the investors.

61. *Mr. Brian Mackenzie* ran a company whose business concerned life jackets: he had invented a refillable rather than a disposable cylinder for inflation and had obtained a patent for it. He had known Mr. Allan Milne of MFSS for a very long time, having first done business with him when Mr. Milne was at Park Row. After Mr. Milne joined MFSS in 2010, Mr. Mackenzie did business through him. Over the years, Mr. Milne had helped with a number of financial products: pensions, insurance and ISAs. Mr. Mackenzie had a good and trusting relationship with him. When Mr. Milne moved to

Midas, Mr. Mackenzie saw no reason why MFSS should not continue as his financial adviser. He did some internet research, and saw that MFSS was regulated by the FCA under what he described as the Sense Network umbrella.

62. Mr. Mackenzie learnt about the scheme from mutual friends and family. One friend was another investor witness, Mr. Graham Hudson. Mr. Hudson had heard Mr. Milne speak about the scheme at events run by a business networking organisation, and Mr. Hudson (an insurance broker) invested in the scheme himself. Mr. Mackenzie's nephew (Magnus Brown) also invested in the scheme. Both Mr. Hudson and Mr. Brown had informed Mr. Mackenzie that Mr. Milne regularly talked about the benefits of the scheme, the interest rates offered and the scheme being secure.

63. In early 2010, Mr. Mackenzie had acquired a good sum by way of savings, and he was looking for a better return on his money than was available from the high street banks, whose rates Mr. Mackenzie described as "very low". He met with Mr. Milne, who told him that the scheme was something which he could not afford to miss. Mr. Milne explained that the scheme was legitimate, that the scheme and Midas were regulated by the FSA, and that the product was a "guaranteed product": i.e. covered by the Government guarantee scheme. He was told that Mr. Milne had known many other people who had participated in the scheme, and some were his own clients. He explained that the scheme was operated by RBS hedge fund traders, and that this explained why the rates of return were better than was available on the high street. Mr. Mackenzie was reassured by the reference to RBS, and by statements from Mr. Milne as to the safety of the investment.

64. Accordingly, in May 2010 Mr. Mackenzie invested £ 100,000 in the scheme. Shortly afterwards on 13 July 2010, in connection with other business, Mr. Mackenzie signed MFSS's standard terms of business letter which contained the provision:

> Midas Financial Solutions (Scotland) Ltd. is not permitted to handle client money and we cannot accept a cheque made out to us (unless it is in respect of an item for which we have sent you an invoice) or handle cash.

65. Mr. Mackenzie's initial investment was for a short 2 month period, and Mr. Mackenzie then decided to roll over the principal and accrued interest (amounting to £ 101,500) for a further period. The letter that he then received was typical of the letters received by investors. It was on MFSS headed paper, and read:

> Dear Mr. Mackenzie
>
> **SHORT TERM DEPOSIT–**
>
> **- GUARANTEED CAPITAL RETURN**
>
> **- GUARANTEED GROWTH 5.25%**
>
> This is a confirmation that an amount of £ 101,500 has been placed using the above product.

> A total return of £ 106,828.75 will be brought about on 8th April 2011. This business was conducted on an execution only basis, that is, no advice was given or sought.
>
> I thank you for your business and shall communicate again on 8th April 2011
>
> Yours sincerely
>
> (signed)
>
> Alistair Greig FFA Cert PFS
>
> Financial Accountant

66. At the foot of the page was the statement:

> Midas Financial Services (Scotland) Ltd. is an appointed representative of Sense Network Limited, which is authorised and regulated by the Financial Services Authority.

67. Sense drew attention to a number of features of the documentation in relation to arguments principally concerning contributory negligence, and in particular the imprudence of the investors, and to some extent ostensible authority. These features were as follows.

68. First, the documentation relating to the deposit of very substantial sums of money was on any view scanty. Mr. Mackenzie had handed over his money in April without any documentation at all, and it was only some time later that a letter, in the terms set out above, acknowledging and confirming the deposit and the interest rate, was received. A number of the investors gave evidence that they had to chase Midas for these letters, and sometimes did not receive them for a number of weeks.

69. Secondly, although investors such as Mr. Mackenze were told about the involvement of the RBS, they did not receive any documentation from the RBS itself. This was in contrast to the position that would obtain if an account was opened with the RBS or another bank, when (as many of the investors acknowledged in their evidence) they would receive documentation from the bank and might need to provide documentation (such as utility bills and proof of identity) to the bank. The MFSS letter itself did not refer either to the RBS or to the Government compensation scheme.

70. Thirdly, some of the investors, including Mr. Mackenzie, were familiar with the type of documentation produced by MFSS itself in the context of regulated investments such as pensions or insurance. For example, a detailed letter of advice on suitability would be received, and this would have been preceded by a "fact find" document as well. Terms of business would also be provided. There was nothing of the kind in relation to the scheme.

71. Fourthly, the letter was understood by Mr. Mackenzie, and indeed all the other investors, to contain a promise by MFSS that the money would earn a guaranteed sum, i.e. the interest set out in the letter. In due course, this would be paid to the investor, or credited to the investor and rolled over if that is what he/ she decided to do.

Furthermore, the interest rates set out in the letter (5.25% in the above example) represented the rate payable for the period of the deposit (here, July 2010 to April 2011) rather than an annualised rate. Mr. Mackenzie, and indeed other investors, were generally aware that the annualised rate was higher, and also how an annualised rate could be computed. (One claimant, Mr. Rognaldsen, who invested late in the story, thought that the rates in the header of the letter were annualised rates, and he was therefore very surprised when he learned that it was the rate for the period of the deposit and thought that perhaps a mistake in his favour had been made).

72. There is no doubt in my judgment that all the investors, including Mr. Mackenzie, appreciated that the rates on offer were high when compared to the rates that could be obtained from high street banks. Many of the investors had a general awareness that the rates were significantly higher than the Bank of England base rate, which (as they also understood) informed the rates which High Street banks would pay. Mr. Mackenzie described the rates offered in July 2010 as “fairly good”. This was in my view an understatement: Mr. Mackenzie and the other investors appreciated that the rates were very good, particularly in relation to the period after the 2008 financial crisis where interest rates had fallen to low levels and the Bank of England base rate was around 0.5%.

73. However, I do not consider that Mr. Mackenzie, or indeed any of the other investors, actually appreciated that the scheme was illegitimate or bogus or dodgy. All of the claimant witnesses were intelligent people and generally speaking they had worked in businesses or in employment for some years, and many had enjoyed a degree of success in their careers. Many of them decided to put significant amounts of their savings into the scheme. I do not consider that they would have done that if they had considered the scheme in some way dodgy, and there was of course no suggestion that they had any knowledge that the scheme was in fact a Ponzi scheme. Nor do I consider that (as Sense suggested in cross-examination of the early witnesses, but not thereafter) the investors should be categorised as “greedy” individuals. They were looking for the best return on their money, and thought that they were dealing with trustworthy people at MFSS. Their confidence in the scheme was created and reinforced by various matters, including: an existing relationship of trust with individuals at MFSS; the fact that the scheme appeared to be operating successfully, with money being paid out when an investor decided to withdraw some funds from the scheme; the fact that Mr. Greig, whom some of the investors met, was presentable and appeared knowledgeable; the investors’ knowledge that others, including friends or people with family connections to the MFSS representative, had invested in the scheme; their belief, reinforced by statements made to them, that the scheme was covered by a government compensation scheme.

74. Fifth, Sense referred to the part of the letter which said that “no advice was given or sought”. This wording was contrary to the way in which most witnesses perceived the reality: they considered that they had been given advice to enter the scheme. None of them, including Mr. Mackenzie, queried the wording. The general theme of the evidence of the Lead Claimants was that this was standard wording of no significance, and that they trusted the MFSS adviser.

75. Sixth, the money was paid over to the MFSS adviser prior to any documentation actually being provided. It was only some time later that an investor received the confirmatory letter. This fact was heavily relied upon by Sense as negativing reliance in the context of the argument based on apparent authority.

76. To revert to the position of Mr. Mackenzie, the broad picture is that – save for small sums which he was paid by way of interest in order to "round down" his investments to round figures – he continued to roll over his 2010 investment of £ 100,000. In May 2012, he had made a further investment of £ 55,000, which he also continued to rollover. His total investment was therefore £ 155,000, although he did withdraw a small amount of interest (£ 1,355.51).

77. Mr. Mackenzie was clearly happy with the way in which his investment was proceeding. Indeed, in mid-2014 he recommended the scheme to his brother. Mr. Milne went to see him, and his brother invested in the scheme. This episode shows that investors such as Mr. MacKenzie did not perceive the scheme as suspect: if so, he would not have recommended it to his brother. It also illustrates the way in which the trust of the investors was reinforced by the apparent success of the scheme, thereby leading to the continued participation of existing investors and the acquisition of new ones.

78. In July 2014, Mr. Milne called Mr. Mackenzie to tell him that there was a rumour that the scheme was in trouble. Mr. Milne sought to reassure him that there was nothing to worry about. A few weeks later, however, Mr. Milne came to visit Mr. Mackenzie at his house. Mr. Milne then told him what he knew at that time, blaming Mr. Greig and saying that he had not known anything about illegal behaviour. Mr. Milne had said that as far as he knew, the scheme was legitimate. Mr. Mackenzie told him that he had only invested because of what Mr. Milne had told him, and Mr. Milne broke down in tears.

79. *Mr Myles Creighton*. Mr. Creighton is a farmer, and he and his wife are both claimants in these proceedings. His introduction to MFSS came through an old friend of his, Mr. John Turnbull. Mr. Turnbull often mentioned his financial adviser, Mr. Kevin Alexander at MFSS, and spoke warmly about him. Mr. Creighton met Mr. Alexander in February 2014, and was predisposed to trust him because he knew that Mr. Alexander had advised Mr. Turnbull for a number of years and there had never been any cause for complaint.

80. At the meeting with Mr. and Mrs. Creighton, which took place at their home, Mr. Alexander explained the scheme: the money would be invested with the RBS and would be used by RBS to fund short-term bridging loans. Mr. Creighton's belief was that bridging finance could be very expensive to a borrower, and it made sense to him that this would enable a high rate of interest to be paid by Midas. The Creightons were also told that the money was safe: RBS was owned by the government, and if the worst happened the money was guaranteed by the FCA. Mr. Alexander explained that if the money was lost, the FCA would pay compensation. Mr Creighton understood that the level of compensation would be £ 85,000 per person, or £ 170,000 for him and his wife. The Creigtons then invested £ 60,000 including a payment of £ 10,000 in cash, being the proceeds of the sale of a caravan.

81. In April 2014, there was a further visit by Mr. Alexander, and the Creightons made a further investment of £ 75,000: the rate of interest for that sum, which was to be deposited for a year, was 12%. Mr. Alexander again reassured them as to the safety of their money: it was invested with RBS who were backed by the government, and the FCA would compensate for any loss. In October 2014, following a press report about Midas concerning allegations of fraud, Mr. Creighton spoke to Mr. Alexander, who assured him that everything was fine. Subsequently, he requested repayment but did not receive it. He tried to speak to Mr. Alexander again, but only succeeded in speaking to

his wife. She told him that Mr. Alexander had money in the scheme too, as had some of his relations. The Creightons had invested £ 135,000 in the scheme, and had withdrawn only £ 2,400.

82. It is not necessary to describe in detail the full circumstances of the payments made by the other investors. Their accounts of their introduction to the scheme varied, but these were in many respects variations on the themes of the accounts given by Mr. Mackenzie and Mr. Creighton. A number of features are, however, noteworthy.

83. First, the investors in the scheme involved some individuals who had no background in financial services, but some individuals such as Mr. Hudson who did.

84. A striking example within this category was Mr. Cutler, who worked at MFSS advising principally on pensions. He invested approximately £ 200,000 which had been bequeathed to him and his two sisters (one of whom was disabled). He had discussed the scheme with Mr. Greig, having heard about it in the office. Mr. Greig told him that it was an account offered by the RBS to him personally in view of his connections. When asked about how RBS could pay such a high rate of interest, Mr. Greig explained that the RBS lent the money to small businesses which were fast growing, and that finance for such companies was expensive. When asked about how RBS could guarantee the high rates of interest since small businesses often fail, Mr. Greig answered that RBS took out indemnity insurance against the failure of their borrowers. Mr. Cutler not only invested himself, but recommended the scheme to other members of his family and to one or two clients.

85. Secondly, the investors in the scheme included close family members of individuals who worked at MFSS. For example, Mrs. Alison Shepherd invested substantial sums on the recommendation of her brother-in-law, Kevin Alexander (who also introduced Mr. and Mrs. Creighton).

86. The accounts of the claimants within these categories are indicative of the fact that individuals within MFSS itself (Mr. Cutler and Mr. Alexander) believed in the genuineness of the scheme. They were prepared to invest in it themselves or recommend their family members to do so. The accounts also illustrate that, whatever the undoubted shortcomings of the documentation, the claimants believed that the scheme was plausible and genuine: a frequent theme in the evidence of the claimant witnesses was that they placed their trust in those who were advising them.

F: The legal basis of the claims and the Claimants' routes to liability

87. Against this factual background, the Claimants contend that there are a number of different routes to liability. The arguments, described in more detail below, were complex, and what follows is a brief outline.

   i) A claim based on FSMA section 39. The Claimants contended that section 39 was engaged because the "scheme" was properly to be characterised as a collective investment scheme ("CIS") within s.235 of FSMA. This meant that it was business for which Sense had accepted responsibility under s.39 and the ARA. Sense contended, as a threshold point, that s.39 was not engaged at all,

because MFSS had exceeded what it was authorised to do under the ARA. But in any event, s.39 was not engaged because the scheme was not a CIS.

ii) A claim based on actual or apparent authority. The essence of the Claimants' argument was that a financial adviser has actual or apparent authority to advise in relation to placing deposits, and this is what the MFSS advisers were doing.

iii) A claim based on breach of Sense's supervisory obligations, coupled with the attribution of the knowledge, conduct and omissions of Mr. Ingram. The essence of this claim was that, through Mr. Ingram, Sense knew of the scheme and did nothing to stop it.

iv) A claim based on vicarious liability. The Claimants contended that Sense was vicariously liable for the tortious conduct of the MFSS advisers in relation to the advice which they gave in connection with the scheme. Alternatively, Sense was vicariously liable for the tortious conduct of Mr. Ingram in relation to the advice which he gave.

v) A claim for breach of Sense's supervisory obligations because Sense failed adequately to monitor MFSS and its advisers. It was to this issue that, primarily, the expert evidence in the case was directed.

vi) A claim, again for breach of Sense's supervisory obligations, based on Sense's failure properly to conduct certain investigations, principally an investigation into the matters revealed by Mrs. Waddingham of Accord. The Claimants contended that if a proper investigation had been carried out, the lack of integrity of Mr. Greig and others would have been revealed, and MFSS would not have been able to continue in business or to operate the scheme.

88. Before addressing the arguments in relation to each of these routes, it is convenient to describe in more detail the regulatory regime relevant to the claims which are advanced.

G: The Regulatory Background

89. The relevant statute for the purposes of the events with which this case is concerned is FSMA and the rules made pursuant to FSMA. The statutory regime in outline is as follows.

The need for authorisation

90. Section 19 FSMA prohibits a person from conducting a "*regulated activity*" in the United Kingdom, unless that person is either "authorised" or "exempt". Under Section 23 (1), it is a criminal offence to act in breach of section 19. The FCA, and previously the FSA, is empowered under Part 4A of FSMA to permit persons to carry on regulated activities following receipt of an application for permission from that person. If permission is given, the applicant then becomes an "authorised person" under FSMA.

91. Section 22 (1) provides that an activity is a regulated activity if is an activity of a "*specified kind*" which is carried on by way of business and if it relates to an "*investment of a specified kind*". "Investment" includes any asset, right or interest: s. 22 (4). Under s. 22 (5) "Specified" means "specified in an order made by the Treasury". This means

that, generally speaking, the identification of "regulated activities" is to be found in secondary legislation rather than FSMA itself: namely, the Financial Services and Markets Act 2000 (Regulated Activities) order 2001 (SI 2001/544) as amended ("RAO") made under section 22 of FSMA. Thus, Article 4 of RAO provides:

> (1) The following provisions of this Part specify kinds of activity for the purposes of section 22 (1) of the Act (and accordingly any activity of one of those kinds, which is carried on by way of business, and relates to an investment of a kind specified by any provision of Part III and applicable to that activity, is a regulated activity for the purposes of this Act.

92. Under RAO, regulated activities include arranging and advising on investments. Article 25 specifies making arrangements for investments for another person to buy, sell, subscribe for or underwrite a particular investment such as a "security" or "a "relevant investment". Article 53 specifies advising on investments such as a "security". A security includes "Units in a collective investment scheme". Other activities include operating a collective investment scheme (RAO Article 51ZG) and accepting deposits. In practice, authorisation to accept deposits is granted only to relatively narrow categories of organisations such as banks, building societies and credit unions.

93. Every authorised person (or firm) has one or more permissions – in its Part IV (and subsequently Part 4A of FSMA) permission or FSA/FCA licence – to conduct different species of investment or financial activity. The Part IV/Part 4A permissions proceed by reference to the "regulated activities" in respect of "specified investments" identified in the RAO.

94. Sense's Part IV (and subsequently Part 4A) permission embraced the regulated activities of:

    i) Advising on investments;

    ii) Arranging (i.e. bringing about) deals in investments;

    iii) Making arrangements with a view to transactions in investments; and

    iv) Agreeing to carry on a regulated activity.

95. However, neither Sense nor (therefore) MFSS was authorised by the FSA/ FCA to handle client money or safeguard client assets.

Appointed representatives

96. FSMA, and its predecessor statute, has provided a mechanism for intermediaries to carry out regulated activities not because they are authorised, but because they are exempt. This has resulted in the creation of "networks" where a principal is authorised, but other intermediaries within the principal's network are exempt. As described above, individuals or small firms who might otherwise find it difficult to obtain authorisation under FSMA can, in this manner, provide financial services. In essence, the ARs take advantage of the authorisation granted to an authorised person, but are not themselves

directly regulated. The key statutory provision is section 39 of FSMA. This section provides:

> " (1) If a person (other than an authorised person) –
>
> (a) Is a party to a contract with an authorised person ("his principal") which –
>
> (i) permits or requires him to carry on business of a prescribed description, and
>
> (ii) complies with such requirements as may be prescribed, and
>
> (b) Is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing he is exempt from the general prohibition in relation to any regulated activity comprised in the carrying on of that business for which his principal has accepted responsibility"

97. Thus an AR of an authorised person is exempt and can in principle carry on a regulated activity without contravening s.19 FSMA. The exemption is therefore conferred by the contract which is concluded between the AR and the authorised person: it is only by its contract that the AR can carry on regulated activities.

98. Importantly, section 39 (3) of FSMA 2000 requires the party who has appointed an AR to accept responsibility for the AR's activities:

> "The principal of an appointed representative is responsible, to the same extent as if he had expressly permitted it, for anything done or omitted by the representative in carrying on the business for which he has accepted responsibility".

99. Responsibility under Section 39 (3) covers both civil and criminal liability, so that a claimant has the ability to pursue both the AR and the principal. This provision, and its statutory predecessor s.44 of the Financial Services Act 1986, reflect the recommendations of Professor Gower in his seminal report, "Review of Investor Protection", on investor protection reform in the 1980s.

100. The regulatory regime relating to ARs, provided for in FSMA s.39, was supplemented by secondary legislation: the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 ("the Appointed Representatives Regulations"). These Regulations contain, for example various requirements as to the contract between the AR and the principal pursuant to which that relationship is created.

101. In practice, the appointed representative regime is widely used, including in the retail investment sector, by "networks" of IFAs, such as Sense. The network carries out compliance, complaints-handling, and other functions. Such networks are made possible and regulated by the scheme contained in section 39 of FSMA, the Appointed

Representatives Regulations and – importantly as far as the present proceedings are concerned and as further described below – the statutory rules made by the FSA/ FCA contained in the Supervision Manual at SUP 12.1.

102. In consequence of this legislative regime, any person who wished to carry on any regulated activity under FSMA/ RAO must be either an authorised person or an exempt person. In contrast, there is no need to obtain either status for activities which are not regulated, such as advising on savings or other deposit accounts.

The regulator and the Handbook

103. Prior to 1 April 2013 there was a single regulator: the FSA. It promulgated general principles and made detailed rules pursuant to powers conferred by FSMA in its Handbook. The FSA had explicit statutory powers to fine and discipline authorised persons (FSMA sections 205 and 206), and impose or obtain other disciplinary and enforcement measures under FSMA. Subsequent to April 2013, the regulator relevant to the present case has been the FCA. Many of the relevant events in the present case took place under the predecessor FSA regime. However, any differences between the two regimes (FSA and FCA) were not material to the resolution of any of the issues in the case.

104. Breach of any regulatory rules in the FSA/ FCA Handbook, including those in the Supervision Manual ("SUP") and the Conduct of Business Sourcebook ("COBS") is actionable as a breach of statutory duty by any private person who suffers loss as a result. In relation to the period prior to 1 April 2013, the governing provision in that respect was section 150 of the FSMA. Since that time, the relevant provision is section 138D (2), which provides

> A contravention by an authorised person of a rule made by the FCA is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty

105. Under the Financial Services and Markets Act 2000 (Rights of Action) Regulations ("Rights of Action Regulations"), regulation 3 (1) (a), a private person generally includes an individual.

106. The statutory obligations of independent financial advisers were set out in the conduct of business sourcebook ("COBS") component of the FSA/ FCA rules. These included obligations:

i) to act honestly, fairly and reasonably in accordance with the best interests of the client: COBS 2.1.1R

ii) to ensure that a communication or a financial promotion is fair, clear and not misleading: COBS 4.2R

iii) to take reasonable steps to ensure that a personal recommendation is suitable for its client, having obtained the necessary information about the client's investment experience, financial situation and investment objectives pursuant to COBS 9.2.1(R) (1) and (2);

iv) to obtain from the client such information as is necessary to understand the essential facts about him and have a reasonable basis for making any personal recommendation: COBS 9.2.2 (R) (1) and (2);

v) to provide a general description of the nature and risks of designated investments: COBS 14.3.2R.

107. In addition, an adviser was required to document its advice and recommendations. COBS 9.4 required the adviser to provide a "suitability" report, which included information as to the client's demands and needs, why the adviser had concluded its personal recommendations were suitable, and explaining the possible disadvantages for the client of the recommended transaction.

108. There is no dispute in the present case that the scheme should never have been sold or recommended to any of the claimants. Therefore the COBS component of the FSA/ FCA rules does not require further analysis. Equally, whether or not the scheme is characterised as a deposit scheme or a CIS (an issue addressed in Section H2 below), there is no dispute that its operation was carried on in breach of the general prohibition in s19 FSMA. This is because both the taking of deposits (RAO, Article 5) and operating a CIS (RAO Article 51ZG, formerly 51) are both regulated activities.

The Supervision Manual

109. The Claimants' claim that Sense was in breach of its supervisory obligations is based on the Supervision Manual. The version of the Supervision Manual current as at 27 September 2007 (the date of the appointment of MFSS as Sense's AR), did not (as far as the issues in these proceedings are concerned) materially change thereafter. The Handbook, including the Supervision Manual, contains "Rules" as well as "Guidance": breach of the former being actionable as a "mini-tort" by private persons. The designation "R" after a provision in the Supervision Manual denotes a "Rule", and the designation "G" denotes Guidance.

110. SUP 12.1.1R provided that Chapter 12 "applies to a firm which is considering appointing, has decided to appoint, or has appointed an appointed representative". SUP 12.4.2R provides that:

> Before a firm appoints as an appointed representative (other than an introducer appointed representative) and on a continuing basis, it must establish on reasonable grounds that
>
> …
>
> (2) the person
>
> (a) is solvent;
>
> (b) is otherwise suitable to act for the firm in that capacity
>
> …
>
> (3) the firm [i.e. the appointing firm] has adequate

> (a) controls over the person's regulated activities for which the firm has responsibility; and
>
> (b) resources to monitor and enforce compliance by the person with the relevant requirements applying to the regulated activities for which the firm is responsible and with which the person is required to comply under its contract with the firm.

111. SUP 12.6.1R provides that the appointing firm must immediately terminate the contract with the AR if at any time the conditions in SUP12.4.2R are not satisfied. SUP 12.6.5R provides that a firm must not permit an AR to hold client money. A key provision for present purposes is SUP 12.6.6R. This provides that a firm must

> take reasonable steps to ensure that each of its appointed representatives
>
> (1) does not carry on regulated activities in breach of the general prohibition in section 19 of the Act and
>
> (2) carries on the regulated activities for which the firm has accepted responsibility in a way which is, and is held out as being, clearly distinct from the appointed representative's other business.

112. Certain other provisions of the regulatory regime, and the Supervision Manual, were relied on by the parties. These are set out in context below: see Section J.

H: The claim based on FSMA s.39

H1: The threshold point

113. The Claimants' first route to liability is based on FSMA s.39. A threshold issue concerned the scope of liability under section 39 in circumstances where (as Sense contended) MFSS had clearly exceeded its actual authority as set out in the ARA, and specifically in terms of handling client money and the products in relation to which it was authorised by Sense to deal. Sense submitted that the section 39 case fell at the first hurdle.

Sense's submissions

114. Sense submitted that for section 39 to be engaged so as to fix it with liability for the acts and omissions of MFSS in relation to the scheme, it needed to be shown that the scheme was business for which Sense had accepted responsibility in writing (section 39(3) read with section 39(1)(b)).

115. In their opening submissions, Sense submitted that section 39 was not engaged because Sense did not authorise, whether in writing or otherwise, MFSS to promote, advise about or otherwise do any act in connection with the scheme. Sense referred to the definition of "Authorised Product" which was defined as "those products, policies, or services … which the AR and its Registered Individuals are authorised to sell or advise

on as notified in the Letter of Authorisation provided by the Company". The letters did not permit advisers to advise on deposit schemes or to accept client money.

116. Moreover, Sense specifically prohibited MFSS from accepting or holding client money: see clause 5.3.6 of the ARA. This provision was replicated in the MFSS terms and conditions of business that were issued to clients. As set out above, those terms specifically informed the client, under the heading "Client Money" that MFSS was *"not permitted to handle client money and we cannot accept a cheque made out to us (unless it is in respect of an item for which we have sent you an invoice) or handle cash"*.

117. Sense said that section 39 should not be applied using a "broad approach". It was important that section 39 be applied with precision, given the onerous consequences of section 39(3) upon a principal. The principal should not be fixed with the statutory liability for the acts and omissions of his AR unless he has plainly authorised them in writing.

118. Moreover, there was a problem with a "broad approach", insofar as such an approach might have the effect of construing an acceptance of responsibility as encompassing an activity for which the principal himself had no permission. In this case, Sense did not have regulatory permission to accept client money or take deposits, and so it would be perverse to construe the permission given by Sense to its ARs as encompassing (and thereby permitting) activities which Sense itself was not permitted to undertake.

119. In its written closing submissions, Sense focused in particular upon the provisions in the ARA which confined MFSS's authority to products and services where there was a "Company Agency". Specifically, Clause 3 provided:

> "3. Subject to clause 2 and in particular subject to the scope of the AR's authorisation as set out in the Letter of Authorisation regarding Authorised Products and the provision of the Services, [Sense]
>
> 3.1.1 authorises the AR acting through its Registered Individuals to sell and advise on Authorised Products and to provide Designated Investment Services, Personal Protection Insurance Services, General Insurance Services and/or Mortgage Services using a Company Agency; and/or
>
> 3.1.2 authorises the AR acting through its Registered Individuals to provide Additional Services using a Company Agency."

A Company Agency was in turn defined as "an agency which [Sense] maintains or has maintained with an institution."

120. The evidence of Mr Netting was (i) that the scheme was not business done using a Company Agency, and (ii) that only Sense could add a product as an approved product on I/O. That evidence had not been challenged by the Claimants, and indeed there had been no request for disclosure of documents relating to Sense's Company Agency arrangements. Moreover, the existence of a Company Agency was an important safeguard for Sense, because without an agency agreement it would be impossible to process a transaction on I/O. Sense wanted the business done through a company agency because then the payment for the business would come into Sense's account via the agency which Sense had with the provider. The permission to an AR to do a certain

type of business meant that Sense could and did set up its systems and controls of oversight and supervision to track that business.

121. Sense recognised that the decision of HHJ Waksman QC in *Ovcharenko v Investuk Ltd* [2017] EWHC 2114 was that the scope of liability under section 39 was not circumscribed by the actual authority conferred under the ARA. However, the case was distinguishable and was not relevant in the present case. In *Ovcharenko*, the business in question fell within the broad definition of authorised business in the relevant agreement, and the defendant was relying upon other clauses and obligations in order to demonstrate that the advice fell outside the scope of business authorised by the agreement. Here, in contrast, the scheme did not fall within the terms of clause 3 of the ARA at all. Clause 3 should be viewed as similar to an insuring clause setting out the scope of coverage. Here, it defined the services by reference to a description thereof, and an element of the definition was that the services must be done using a company agency. Unlike *Ovcharenko*, this is not a case where the advice or services are within the definition of what was authorised, but, notwithstanding, some breach of a different clause of the agreement is said to have the effect that the business was not authorised.

122. Sense also submitted that even had there been a "Company Agency" in existence, the scheme would still fall outside the scope of the ARA because it could not be brought within it using the "Additional Services" clause. This was because advising about or operating the scheme was not "a service of a kind that is often provided by" an IFA.

123. In oral submissions, Sense emphasised that the business in question could never be done through a company agency, because of its illegality. Mr. Howarth placed particular reliance on the words "part of" in s. 39 (1) as showing that the principal can cut down the scope of the authorisation which he gives the AR.

The Claimants' submissions

124. The Claimants' submissions traced the public policy origins basis for the regime of statutory agency and vicarious responsibility for ARs under FSMA, specifically Professor Gower's seminal report on investor protection reform in the 1980s. Professor Gower wished to avoid the need for individual registration of tied salespersons (typically then of life insurers), even where (as was usually the case) they were self-employed. The trade-off was to be that the company to which they were tied must accept full responsibility for the activities of the salespersons. Reference was made in particular to a trilogy of recent cases: *Ovcharenko; Palmer v Financial Conduct Authority* [2017] UKUT 313 (UT), [2017] All ER (D) 57 and *R v Financial Ombudsman (on the application of Tenetconnect Services Ltd)* [2018] EWHC 459 (Admin).

125. The Claimants submitted that a broad approach should be taken to the question of the business for which a principal has accepted responsibility, especially in light of the public policy basis of vicarious responsibility. Whenever courts were faced with an argument which attempted to put a narrow construction on s. 39, the argument has been rejected, and a construction consistent with the legislative and regulatory intent of the section preferred. The Claimants submitted that s. 39 was one of two principal measures (alongside s.138D of FSMA/ SUP 12) designed to ensure the legislative and regulatory intent that clients of AR firms are treated as favourably as clients of directly regulated FSA/FCA firms.

126. At the heart of the Claimants' submission was the proposition that the only real question that mattered, for the purpose of s.39, was whether the scheme was a CIS. If it was, then there was no answer to the claim under s.39. This was because arranging or advising participation in CIS was (a) within the scope of the Midas advisers' express actual authority and (b) constituted business for which Sense accepted statutory responsibility under s 39. In other words, if a generic type of product – on this hypothesis collective investment schemes, a species of designated investment, and an investment under the RAO – is one which Midas advisers could arrange or advise upon, Sense's authority conferred upon Midas to so deal extended to all financial products falling within that generic description.

127. In response to Sense's case based upon "Company Agency", the Claimants submitted that this could not affect Sense's potential liability under s. 39. Just as in *Ovcharenko,* this was simply a matter which affected the relationship between principal and AR inter se, but it had no impact on the AR's liability under s.39. They relied upon the origins of section 39 (and its predecessor) in the report of Professor Gower: *Review of Investor Protection*: *Part 1:* in particular paragraph 8.50 and Recommendation 58.

128. In terms of statutory construction, Mr. McMeel drew attention to the interrelationship between s.39 (1) and the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217) and to the "generic" wording in s.39. There was a pyramidal scheme of laws which made networks possible and by which they were regulated, namely the primary legislation (s.39), the secondary legislation (SI 2001/1217) and the statutory rules made by the FSA/ FCA: the Supervision Manual, chapter 12.

129. The focus of his argument in that respect was s.39 when read together with SI 2001/1217. Thus, section 39 (1) referred to a contract which permits the AR to carry on business of a "prescribed description". SI 2001/1217 was made by the Treasury in the exercise of the "powers conferred on them by section 39 (1) and 417 (1)" of FSMA 2000. Regulation 2, headed "Descriptions of business for which appointed representatives are exempt" sets out various categories of business comprising different activities. Each activity is "prescribed for the purposes of subsection (1) (a) (i) of section 39 of the Act". The activities include:

> (a) an activity of the kind specified by article 25 of [the RAO] (arranging deals in investments), where the arrangements are for or with a view to transactions relating to securities …
>
> (c) an activity of the kind specified by article 53 of [the RAO] (advising on investments).

130. It was these broadly defined "generic" activities which would form the subject-matter of the Part IV authorisation granted to Sense, and which in turn could in effect be passed on to an AR so as to make him exempt under s. 39 (1) pursuant to an AR agreement. Thus, the exemption granted was an exemption at a "generic" level. Section 39 when read together with SI 2001/1217 is concerned with general types of categories of business (e.g. advising on investments) which can be passed across to an AR. In this connection, Mr. McMeel emphasised that the scope of the Part IV authorisation to Sense is publicly known, via the Financial Services Register; whereas the particular "Company Agencies" between Sense and product providers is confidential information

and is not generally available. Accordingly, the relevant exemptions in section 39 are conferred in "broad generic terms" and they are in turn based on Sense's own Part 4 permission. Accordingly, section 39 applied to fraud or mis-selling as long as it was within the generic categories of business for which Sense had received authorisation from the regulator to conduct, and for which an exemption had in turn been passed on to MFSS.

Analysis and conclusions

131. I do not accept the Claimants' argument that the scope of a principal's responsibility under section 39 is to be determined simply by identifying generic categories of business. Section 39 (1) (a) (i) does indeed refer to "business of a prescribed description", and it is clear that this is a reference to the generic categories of business which are prescribed in SI 2001/1217. I also agree that the reference to "the whole or part of that business" in section 39 (1) (b) does refer back to the generic "business of a prescribed description". However, it does not in my view follow that the principal is bound to accept responsibility for all business falling within these generic descriptions. Mr. Howarth was right to draw attention to the fact that section 39 (1) (b) does contemplate that the principal may decide to accept responsibility for only "part of" the business of the (generic) prescribed description. Accordingly, the section does contemplate that the principal can cut down the scope of the "business of a prescribed description" for which he is undertaking to accept responsibility, as provided for in section 39 (1) (b) and 39 (3).

132. This conclusion is not surprising, in circumstances where: (i) under the 1986 Act, an AR could be both exempt and authorised; and (ii) under the present statutory regime, it is possible for an AR to act for more than one principal – see, for example, SUP 12.2.4G (which makes it clear that FSMA 2000 and the AR Regulations "do not prevent an appointed representative from acting for more than one principal") and SUP 12.6.6R (which requires a firm to take reasonable steps to ensure that its AR "carries on the regulated activities for which the firm has accepted responsibility in a way which is, and is held out as being, clearly distinct from any of the AR's other business performed as AR of another firm"). In both situations, a particular principal may wish to place limits upon the "part" of the overall "generic" business carried on by the AR for which he wishes to accept responsibility. It also seems to me that, in context and as indicated by SUP 12.2.7G (which identifies the various categories of business "for which an appointed representative may be exempt"), the reason why there is a "generic" reference in section 39 to "business of a prescribed description" is that it is only in relation to such business that it is possible for an AR to become exempt pursuant to that section. It does not follow that a principal can only accept responsibility for a "generic" category of business.

133. Furthermore, the authorities on section 39, and its predecessor s.44 of the Financial Services Act, show that it is certainly relevant to consider the terms of the AR agreement itself in order to determine the "business for which his principal has accepted responsibility in writing". Indeed, the very concept of "business" for which responsibility has been accepted must require reference to the terms of the AR agreement, since otherwise there would be no starting point for the analysis. As Mr. McMeel correctly submitted during closing: "section 39 acts in conjunction with the contract, the AR agreement, and so what you are accepting responsibility for is what you are accepting responsibility for under the contract". There is no indication in the

wording of section 39, or in the case-law, that indicates that the business for which responsibility is accepted is to be determined not by reference to the contract, but by reference to the authorisations granted to the principal which are to be found in the Financial Services register.

134. Thus, in *Emmanuel v DBS Management PLC* [1999] Lloyds Rep P.N. 593, Jonathan Sumption QC, sitting as a Deputy Judge considered the terms of clause 2.1 of the AR agreement in that case, pursuant to which the AR was authorised to introduce applications by clients of the AR "for new contracts for submission to institutions specified by the associate and approved by the company". The issue was whether the principal was liable for advice given to a client by the AR to buy shares in the AR itself and lend money to the AR. The judge held that the relevant transaction was not within the scope of that agreement. It was a transaction directly between the AR and the plaintiffs for investment in the AR, and was therefore not a case in which it could be alleged that it fell within the scope of that for which the principal had accepted responsibility for the purposes of section 44 of the 1986 Act (the predecessor of section 39). The importance of considering the terms of the AR agreement in context is also clear from the judge's rejection of an argument based upon apparently wide wording of another clause, 2.3 (4):

> "It is envisaged by clause 2.3(4) of the Agency Agreement that ITIP [the AR] may give investment advice as part of its functions under the Agency Agreement, but it is plain from the terms of that provision and from its context that the advice envisaged is advice related to transactions that are within the scope of clause 2.1 of the Agreement"

135. Similarly, in *Martin v Britannia Life*, Jonathan Parker J. considered the scope of clause 2.1 of the applicable AR agreement, and the extent to which the relevant advice fell within its scope. The judge held that the agent's authorised activities under the AR agreement were sufficiently wide to include advice in relation to a mortgage transaction. As the Claimants recognised in their opening submissions, the application of section 44 of the 1986 in *Martin* was analysed as being dependent upon the scope of the adviser's actual or ostensible authority.

136. However, it was also accepted by the defendant in *Martin* (see paragraph [5.2.10]) that a number of express limitations on the AR's authority to bind the principal "take effect subject to the statutory agency imposed by section 44 (6) of the 1986 Act". Accordingly, I agree with the Claimants that liability under section 39 (and its predecessor) cannot simply be answered by asking whether a particular transaction was within the scope of the AR's actual authority. This is also clear from the two subsequent cases, *Ovcharenko* and *TenetConnect* discussed below. As *Jackson & Powell* state at paragraph 14-017:

> First, whatever the position at common law, the principal is responsible for *anything* done or omitted to be done by his appointed representative in carrying out business for which the principal has accepted responsibility "to the same extent as if he had expressly permitted it". Thus the principal will be liable to third parties and accountable to his regulator, for the activities of his appointed representative, as if the principal had given express permission for the relevant activities of the appointed representative. In particular, the principal will be liable to third parties on contracts made by his representative

without the third party having to prove that the representative was actually (or ostensibly) authorised by the principal to act.

137. In *Ovcharenko,* HHJ Waksman QC considered the scope of Clause 3.2 of the AR agreement in that case, and went on to hold that the relevant investment advice was "firmly encompassed by the permitted services in the authorised representative agreement": see paragraph [32]. He said that the "business for which responsibility had been accepted encompasses the services set out in Clause 3 of the authorised representative agreement". Thus, section 39 was engaged notwithstanding other provisions of the AR agreement which imposed obligations or restrictions upon the AR; specifically, not to offer inducements, and an obligation not to do anything outside clause 3. The judge considered that these restrictions were matters which applied between the principal and the AR inter se, and did not affect liability under s.39.

138. Most recently, in *TenetConnect*, Ouseley J applied the decisions in both *Martin* and *Ovcharenko*, in circumstances where it was common ground that liability under s.39 "was not to be determined as a matter of the contractual law of agency": see paragraph [61]. The basis of the decision in *TenetConnect* was that the relevant advice on "unregulated" investments was sufficiently closely linked to the advice on regulated investments, which the AR was authorised to give. The case therefore again supports the proposition that in ascertaining the scope of section 39, and the question of the business for which the principal has accepted responsibility, it is relevant to consider the terms of agreement between the principal and the AR. It is implicit in the decision that if the advice on the unregulated investments had not been sufficiently closely linked to advice which the AR was authorised to give, then there would have been no liability under section 39.

139. I also agree with the Claimants that the authorities indicate that it is appropriate to take a broad approach when seeking to identify the "business for which he has accepted responsibility". The fact that there may not be actual authority for a particular transaction, for example because of breach of an obligation not to offer an inducement (*Ovcharenko)*, or because there was no authority to advise on a related transaction (*TenetConnect)*, or because certain duties needed to be fulfilled before a product was offered, does not mean that the transaction in question falls outside the scope of the relevant "business" for which responsibility is taken. Equally, the approach must not be so broad that it becomes divorced from the terms of the very AR agreement relied upon in support of the case that the principal has accepted responsibility for the business in question.

140. In the present case, I agree with Sense that the scheme, and advice in connection with that scheme, were well beyond the scope of the "business" for which Sense accepted responsibility pursuant to the AR agreement. It is beyond serious argument that the activities of MFSS and Mr. Greig in relation to the scheme, both in terms of operating it and advising upon it, were wholly unauthorised. It is no part of the ordinary business of a financial adviser to operate a scheme for taking deposits from clients. As the Claimants' expert, Mr. Morrey, said: "operating the scheme, so having the monies under your control, clearly is not the work of a financial adviser". Mr. Ingram's evidence was that he knew that a firm of financial advisers should not be involved with the scheme, including because the firm was not allowed to handle client money and that the scheme was business of a kind that a properly regulated firm should not be involved

with. Mr. Ingram was referring to the express prohibitions in clause 5.3.6 and 5.3.7 against MFSS accepting or holding or handling client money.

141. Furthermore, the operation by MFSS of a deposit scheme was clearly illegal, in contravention of section 19 of the Act. MFSS was accepting deposits within the meaning of the RAO and FSMA, without being authorised to do so, in breach of that general prohibition. Sense itself had no authorisation to accept deposits, and (as the FCA correctly stated in paragraphs 9 – 11 of their petition), the acceptance of deposits is in any event not "business of a prescribed description" within the meaning of s. 39 of FSMA 2000. The activity of accepting deposits was not therefore something which Sense could authorise MFSS to do so as to engage s.39.

142. In these circumstances, and irrespective of the argument on "Company Agency", it is impossible to construe any provision of the AR agreement as authorising MFSS to advise on or arrange investment in what was an illegal scheme and one which involved MFSS taking and holding client money.

143. In addition, the Claimants' case – that Sense did accept "responsibility" for the relevant business – requires one to ignore the contractual provisions in Clause 3.1 of the AR Agreement. This makes clear that MFSS's authority to provide "Designated Investment Services", and various other services including "Additional Services", only related to products and services "using a Company Agency". This was an "agency which the Company [i.e. Sense] maintains or has maintained with an institution". I agree, for the reasons given by Sense as summarised above, that this was a very important protection for Sense in terms of the controls which it put in place. There was clearly no "Company Agency" that was applicable to the scheme.

144. Against this background, it would certainly be counter-intuitive if not surprising, even taking a "broad approach" to section 39, to reach the conclusion that the relevant business carried on by MFSS – i.e. in accepting deposits and advising clients to make the deposits – was "business for which he has accepted responsibility" within the meaning of s 39 (3). Unlike *Martin, Ovcharenko* and *TenetConnect,* there is no provision in the AR agreement which can be identified as providing the foundation for the argument that responsibility was accepted. Unlike *TenetConnect*, this is not a case where the deposits were closely linked to regulated advice. For example, none of the lead claimants were given advice to sell regulated investments with a view to investing in the scheme. In all cases, the investments in the scheme were made with savings which the claimants had available to them.

145. Indeed, the present case is the converse of cases such as *Martin* and *TenetConnect*. In both of those cases, the claimants were able to identify authorised advice to which the (allegedly) unauthorised advice was closely connected. In the present case, however, the situation is the reverse. MFSS was running an unauthorised deposit-taking scheme. The scheme was, as I have said, not "business of a prescribed description". Any advice that was given in connection therewith was therefore closely connected with unauthorised activities, and therefore must fall outside the scope of section 39; there being no basis for saying that it was "business of a prescribed description" for which Sense had accepted responsibility in writing.

146. Accordingly, even if the Claimants succeed in their case (considered below) that the scheme was a CIS as defined by FSMA s.235, I do not consider that it forms part of the

business for which Sense accepted responsibility under s.39. However, in case that conclusion is wrong, I turn to consider the arguments in relation to CIS.

H2: Collective Investment Scheme

The statutory context

147. If the scheme was a CIS, it would be an Unregulated CIS, or "UCIS". But this distinction is not material to the issues for resolution and I will simply refer to "CIS". The statutory context for the parties' submissions is as follows.

148. In order to be a CIS the scheme in question must satisfy the statutory definition given in section 235 FSMA. This section provides as follows:

> "(1) In this Part 'collective investment scheme' means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.
>
> (2) The arrangements must be such that the persons who are to participate ('participants') do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions.
>
> (3) The arrangements must also have either or both of the following characteristics:
>
> > (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;
> >
> > (b) the property is managed as a whole by or on behalf of the operator of the scheme …"

149. Section 235 was considered by the Supreme Court in *FCA v Asset Land* [2016] UKSC 17 ("Asset Land"). In *Asset Land*, Lord Sumption JSC (with whom the remainder of the Court agreed) explained the approach to be taken when considering whether an arrangement constitutes a CIS:

> [88] I would agree with the submission, which provided the abiding theme of the Authority's argument, that it is important when construing a regulatory statute of this kind not to allow technical distinctions to frustrate the purpose of the legislation. But the Financial Services and Markets Act 2000 cannot be construed on the assumption that it was intended to regulate every kind of investment in which members of the public are liable to have advantage taken of them by an unscrupulous intermediary. … In a statute such as the Financial Services and Markets Act 2000, which deliberately sets out to regulate some forms of investment but not others, the omission of some transactions from the regulatory net cannot of itself be regarded as compromising the efficacy of the statutory scheme. …The consequences of operating a collective investment scheme without authority are

sufficiently grave to warrant a cautious approach to the construction of the extraordinarily vague concepts deployed in section 235. Arden LJ was surely right in *Financial Services Authority v Fradley* [2006] 2 BCLC 616, para 32, to say that the section "must not be interpreted so as to include matters which are not fairly within it". It must, moreover, be interpreted in a way that provides intelligible criteria which can be applied by professional advisers considering schemes in advance of their being marketed. The Treasury has a wide power under section 235(5) to exempt particular categories of transaction, but criminal liability and the avoidance of contracts are not results which can properly be made to depend wholly on the discretion of the Treasury or the enforcement division of the Financial Conduct Authority.

[89] It follows that any conclusion that [on the question whether a scheme is a CIS] must be firmly founded on the language and purpose of section 235, without making arbitrary teleological assumptions."

150. In determining whether the scheme was a CIS, the following material propositions emerge from *Asset Land* (taken from the judgment of Lord Sumption JSC at paragraph [91]):

a) "arrangements" should be understood in a "broad and non-technical sense";

b) "arrangements" covers "any understanding shared by the parties about how the scheme would operate, whether legally binding or not";

c) "it also includes consequences which necessarily follow from that understanding or from the commercial context in which it was made";

d) the definition is "concerned with substance and not with form".

e) Accordingly, the arrangements are not to be analysed or construed simply by applying strict contractual construction.

151. Lord Sumption JSC also explained that: "it is … important to emphasise that it is concerned with what the arrangements were and not what was done thereafter". However, "what was done thereafter may throw light on what was originally understood. It may for example serve to show that some record of the understanding was a sham". Ultimately "whether the scheme is a collective investment scheme depends on what was objectively intended at that time and not on what later happened, if different".

152. Two provisions of the Schedule to the Financial Services & Markets Act (Collective Investment Schemes) Order 2001 were also relevant to the parties' arguments (SI 2001/1062). This identifies certain arrangements which do not amount to a CIS. The Claimants placed reliance on paragraph 3:

"Arrangements do not amount to a collective investment scheme if the whole amount of each participant's contribution is a

> deposit which is accepted by an authorised person with permission to carry on an activity of the kind specified by article 5 of the Regulated Activities Order (accepting deposits) or a person who is an exempt person in relation to such an activity".

153. Sense relied upon paragraph 6:

> "Arrangements do not amount to a collective investment scheme if—
>
> (a) they are arrangements under which the rights or interests of participants are rights to or interests in money held in a common account; and
>
> (b) that money is held in the account on the understanding that an amount representing the contribution of each participant is to be applied—
>
> (i) in making payments to him;
>
> (ii) in satisfaction of sums owed by him; or
>
> (iii) in the acquisition of property for him or the provision of services to him."

The Claimants' submissions

154. The Claimants' Statement of Case had originally focused on the question of whether or not the scheme was to be categorised as a "deposit" or a CIS. If the former, then there would be no liability under section 39; essentially because it was not necessary to obtain authorisation to advise on, for example, ordinary bank deposits. If the latter, then there would be a liability under s. 39. However, and following an amendment to the Statement of Case at the start of trial, the Claimants made it clear that their case was more nuanced. The Claimants contended that it was not necessary to draw hard and fast distinctions between a deposit and a CIS. There may be an overlap between a CIS and a deposit, and the Claimants contended that the scheme was a CIS and in any event a deposit. In that connection, the Claimants relied upon paragraph 3 of SI 2001/1062. This contained a carve-out of deposits provided that they were accepted by a person with authorisation to accept deposits. This carve-out was necessary because, in view of the wide words of s.235, otherwise every bank account with mixed contributions, such as a husband and wife joint account, would arguably be a CIS.

155. The Claimants submitted that based on the language of s.235, and the decision in *Asset Land*, it was clear that the scheme was a CIS. The property which comprises the subject-matter of a CIS can include money. In this case, the contributions to the scheme were the scheme property. The requirement that "persons taking part in the arrangements" should "participate in or receive profits or income arising from the acquisition [etc] of the property" was satisfied here: the Claimants were informed that they would be

participating in the scheme and getting the benefit of Mr. Greig's relationship with RBS and enhanced returns on their money.

156. The other requirements of section 235 were also satisfied. The participants did not have day-to-day control (see section 235 (2)). The participants had surrendered control of their money and Mr. Greig and/or Midas were in control of that money. The arrangements had either or both of the characteristics in section 235 (3). Those contributions were pooled by being mixed in the scheme account: i.e. the account of Mr. Greig with the name "Midas Financial – Aberdeen". It was sufficient that pooling had happened, even if the scheme had not been promoted on the basis that there was to be pooling. The property was to be managed as a whole by or on behalf of the operator of the scheme, namely Mr. Greig.

157. There were obvious regulatory reasons why Ponzi schemes, whether fraudulent, unauthorised or both, were treated as falling within section 235 of FSMA. This was illustrated by the decision in *O'Neal v Gale* [2013] EWCA Civ 1554 where there was a Ponzi scheme involving "risk free" pooled betting on football matches. The Claimants also referred to the general discussion of CISs in G Walker and R Purves (eds), *Financial Services Law* (4th edn, 2018) paras 22.01, 22.03, 22.13-22.19.

158. It was no answer that the scheme promised a fixed return, rather than a share in profits (or losses). A CIS would commonly involve participants taking the risk on the underlying scheme property, so that they would receive profits or suffer losses dependent upon the performance of the scheme. But there was nothing in the statutory language which required that there should be an inherent element of uncertainty. The fact that this scheme offered a fixed return did not prevent the scheme from being a CIS.

159. Mr. McMeel emphasised the breadth and open textured nature of the statutory definition, and that it was concerned with an attempt to meld together people's wealth, people's assets, with a view to getting a return. He said that all or nearly all Ponzi schemes are caught by s.235 and that this was a desirable public policy outcome. The statutory policy was that people who gather in money from multiple participants to manage it for a scheme should be regulated. People who are planning to be investment managers should be brought within the regulatory framework.

160. The Claimants submitted that paragraph 6 of SI 2001/1062 had no application. This exception was concerned with solicitors' client accounts and the like. That paragraph envisaged a trust-based arrangement, like a solicitor's client account, where all the client contributions were ring-fenced and subject to a trust between the firm and the client. Reliance in that connection was placed on G Walker and R Purves (eds), *Financial Services Law* (4th edn, 2018) para 22.44.

Sense's submissions

161. Sense submitted that an essential feature of a CIS was absent. The Claimants did not accept arrangements to "participate in" the "profits or income" produced by the scheme. The simple reason for this conclusion is that the return was not dependent upon profits or income being generated. Participation in the scheme is not the same as participation

in profits or income arising from its subject matter. A CIS has within it an inherent element of uncertainty and of risk: i.e. the return is dependent upon profits or income being generated. The scheme in question, and its explanation to the Claimants, had no such element of risk. It was represented to be a simple deposit in an RBS bank account that returned a fixed rate of interest, regardless of any external influence or activity. Without exception, the Claimants said that they understood that the arrangement presented to them was that they would receive back the sum deposited, together with the specified interest, on the precise day promised. The sum returnable was not variable in any way. This was not, therefore, a collective investment in which investors hoped to receive a return representing a proportionate share of profit or income from something done with the money they handed over.

162. Thus, the essential word in section 235 (1) was "participate". To receive a specified sum by way of interest is not to "participate in profits or income" from an investment. The concept of "participation" connotes that a participant understands and agrees that he will receive his share of "profits or income", the amount of that share being necessarily variable.

163. Sense submitted that it was irrelevant to consider the explanations, which were given to those depositors who did enquire, as to how RBS could pay those rates of interest. It was essential not to confuse (i) the arrangements explained to Claimants about the returns they would receive with (ii) the question of <u>how</u> the returns promised might be generated, since point (i) is not, according to the arrangements, in any way dependent on or influenced by point (ii).

164. Sense also relied upon the exemption in paragraph 6 of SI 2001/1062, and upon the analysis of Laddie J. in *The Russell-Cooke Trust Company v Elliott* (unreported 16 July 2001, available on Westlaw 2001 WL 753378). Sense submitted that the money was here held in a common account on the understanding that it would be returned to each of them, as individuals, in accordance with the rates and timescales quoted. There was, therefore (in the words of Laddie J) no "*clubbing together to make a common investment*". In the context of paragraph 6, Sense also relied upon the fact that the money was not in fact applied in any form of investment, but was simply collected together in the account and misappropriated by Mr. Greig.

Analysis and conclusions

165. The starting point is to consider whether there were "arrangements" which fell within s 235 (1), applying the approach in *Asset Land*: viz, that "arrangements" is a broad and untechnical word, comprising any understanding shared between the parties to the transaction about how the scheme would operate, whether legally binding or not and viewed at the time when the arrangements were made.

166. The unusual feature of the present case is that no documentation, such as a brochure, was produced which explained the nature of the scheme to the participants. The only documentation with which they were subsequently provided was the letter from MFSS which confirmed receipt of the funds and undertook to make a fixed payment on a specific day. This means that the nature of the arrangements is to be ascertained by considering, principally, the oral evidence as to what the different claimants were told.

Also relevant is the evidence of those who worked at MFSS as to their understanding of the scheme, in particular those (such as Mr. Ingram and Mr. Cutler) who introduced people to it; because their understanding is likely to have been reflected in what clients were told.

167. Although the level of detail varied from claimant to claimant, there were in my view a number of important features of what they were told which applied generally.

168. First, they were given to understand that there was indeed a scheme in operation, and that it had a number of participants. Indeed, in most cases the individuals who gave evidence had known of other people, including family members, who had previously successfully invested in the scheme.

169. Secondly, they were given to understand that the money that they gave Mr. Greig or the other advisers at MFSS – which was given (save for one cash payment by Mr. Creighton) by way of a cheque – involved money being passed on to the RBS, and that the money was therefore safe. Copies of some of the cheques written by the Claimants were in the hearing bundles, and as might be expected these were made payable to "Midas" or "Midas Financial", rather than to the RBS.

170. Thirdly, they were told that by investing their money in this scheme, they would receive interest payments which were higher than those generally available. Some claimants received more detailed explanations as to how it was that RBS would be able to pay (and Midas would be able to pass on) the promised rates: for example because there would be some form of trading operation, or the provision of bridging loans, or other profitable activities which would generate monies which could explain the rates being offered.

171. The claimants' evidence included the following:

a. Mr. and Mrs. Ross were introduced to the scheme via their son-in-law: he and their daughter had already invested money in the scheme, and the money had successfully been withdrawn. They were told by Mr. Towe of MFSS that the scheme was run by RBS and that Midas was lending money to RBS, which Mr. Ross understood as RBS attempting to raise money akin to financing through bonds.

b. Mr. Lee was told about the scheme by Mr. Towe, who described it as a short term deposit scheme. He was told that RBS were utilising it as a means of raising funds for financial bond purposes. He understood this to mean that his money would be aggregated with the investments of others, and that the money would be pooled together in the Midas bank account and then sent to RBS. RBS was therefore raising money for their own purposes and were willing to pay over the market rate for borrowing money.

c. Mrs. Liddell was told by Mr. Greig that he would put the money into the RBS where it was guaranteed to be safe because it was a bank; and specifically that he had a number of clients who deposited money with him in this way and because he had so many clients he could get special rates of interest.

d. Mrs. Baylis came into the scheme after her mother, Mrs. Liddell, had made an investment on her behalf. In due course Mrs Baylis took over the management of the investment. She was told by David Laing that the scheme was with the RBS, and that his family were investing in the scheme. She was satisfied with the name RBS being mentioned, and accepted Mr. Laing's advice to invest.

e. Mr. Masson was introduced through Mr. Ingram. He was told that the scheme was protected through the RBS. The money was paid into RBS and invested from there. He was convinced that the money would go to RBS and that it was backed by them.

f. Mr. Ansell in his witness statement said that Mr. Greig described a scheme whereby his money could be invested on favourable terms with the RBS. Mr. Greig said that he had an arrangement with the RBS and that the money would be sent to a high interest account which is only open to a select few of its personal clients.

g. Mr. MacKenzie was aware of the existence of the scheme as a result of hearing of it from contacts associated with a local business networking group. He knew from mutual friends and family that Mr. Milne gave speeches at group meetings about the benefits of the scheme. Specifically, two friends of his who were part of the business network had invested in the scheme, and had told him of its benefits. In due course, he met Mr. Milne who described the scheme as being operated by RBS hedge fund traders, and that this explained why the rates of return were better than was available on the high street. He explained that he made out cheques to Midas, who then passed the money on to RBS. He believed that his money would end up in an account with the RBS; that his deal was with Midas, that Midas had a deal with RBS, and that this explained how Midas could pay significant amounts of interest.

h. Mr. Hudson described the meetings of the networking group referred to by Mr. Mackenzie. At those meetings, Mr. Milne would promote the scheme, perhaps once a quarter. His pitch was that Midas had special arrangements, and if anyone knew of somebody with a large lump sum of money, Midas were the people to come and talk to. Mr. Hudson understood that there was an arrangement with RBS hedge traders, and that was why they could offer better rates of return.

i. Mr. Lucas' evidence was that Mr. Greig explained that Midas had access to deposits with the RBS that were not generally available on the high street, but that these deposit schemes could be made available to Midas clients who had significant amounts to invest. Mr. Lucas said that he understood from the meeting that the money would be pooled with the money of others and placed in an RBS account.

j. Mrs. Shepherd agreed that her investment in the product was motivated by the mention of the Royal Bank of Scotland.

172. This evidence gives a sufficient overview of the way in which the arrangements were explained by Mr. Greig and the other advisers at MFSS. It is also consistent with the way in which a number of witnesses who worked at MFSS described the arrangements.

    i) Mrs. Greig agreed that the scheme was simple. Clients deposited money which was put into the RBS, and they would receive their money back on a particular day with interest.

    ii) Mrs. Dowall's evidence was that she had been told by Mr. Greig that the scheme was the result of a deal with the RBS whereby the bank gave enhanced interest rates for money deposited for business loans to their customers.

    iii) Mr. Cutler's evidence was that there was no glossy brochure, but he was told that the scheme was operated through RBS. It had been offered to Mr Greig almost as a special deal. He was privileged to be allowed into this type of investment. He also described it as "an RBS scheme that was done, similar to sort of the things nowadays like the lending circle, or whatever they are called; these peer–to–peer things. That is the way it was explained to me. So I understood it was the Royal Bank that was ultimately in charge".

173. Against this background, I consider that the Claimants summarised the position fairly in their submission; namely that investors were told that they would be participating in a scheme and getting the benefit of the relationship of Mr. Greig/ MFSS with RBS and therefore enhanced returns on their money. Indeed, Mr. Howarth's summary of what happened was not dissimilar: as he said in closing "the claimants here gave their money to Mr. Greig on the understanding that he would put it into a special account to which he had access, and they would get a very good rate of interest". In the light of these facts, I now turn to the question of whether s.235 applies in the circumstances.

174. The language of s.235 (1) is very broad indeed. As Lord Sumption said in *Asset Land*, para [12], it is a "wholly general description of collective investment schemes which on its own would cover virtually all cooperative arrangements for deriving profits or income from assets". The breadth of the statutory definition is illustrated by the exemption for joint deposits in paragraph 3 of SI 2001/1062.

175. I consider that the arrangements as described to the Claimants fall squarely within this very wide language. They were all given to understand that there was a scheme in existence in which they had the opportunity to participate. If they gave their money to Mr. Greig/Midas, they would "participate in or receive profits or income arising from" the "management" of that property. Section 235 (1) makes clear that the property in question can be "money". It can therefore be the very money which the participants contribute to the scheme.

176. Sense argued that there was no real "management" of the money, so that the case fell outside s235 (1). They submitted that simply putting a number of persons' money into a bank account is not to manage it. I disagree. Management does not necessarily require a great deal of hard work. It can simply be receiving money, paying it over to a person (RBS) with whom there is a close relationship and a special deal enabling high rates of interest to be earned, and receiving it back and accounting to the investors for the principal and interest.

177. It is true, as Sense pointed out, that the scheme promised a fixed return. It was not therefore dependent on the actual performance of any investments or other assets which were acquired or trading using the money. However, there is nothing in s.235 which imposes a requirement to this effect, or requires an element of 'uncertainty' as to the returns of the scheme. I agree with the Claimants that a fixed return is compatible with a CIS as defined in s.235.

178. Sense's submissions drew a distinction between participating in the scheme, and participating in the profits or income arising from its subject matter. I do not consider that it is appropriate to draw this distinction. The relevant arrangement, as understood at the start, was that participation in the scheme would result in the receipt of profits or income. The statutory language in s.235 (1), particularly the word "income", is certainly wide enough to include the payment of interest. Moreover, Sense's emphasis on the word "participate" in this context is not persuasive, since section 235 (1) refers "participate in or receive profits or income."

179. It is also true, as Sense contended, that the "arrangements" were not sold or promoted on the basis that the scheme needed to raise some minimum level of funding from different participants in order to provide the promised returns, or that the returns were in some way dependent upon the amount of the funding received from different participants. Again, however, there is nothing in the wide language of s.235 (1) which requires features of this kind. Many CISs are no doubt promoted on the basis that a minimum level of overall funding from different participants is required in order to acquire a particular asset or receive a particular benefit. But this is not an essential requirement, and there is no reason why one would expect it to be present in all cases and in particular a case such as the present, where a scheme has been in existence for a number of years and has apparently been operating very successfully.

180. As Lord Sumption also stated (para [90]), the breadth of the description in 235 (1) is narrowed down by (as far as relevant to the present case) subsections (2), (3) and (4). However, none of these provisions is of any assistance to Sense in the present case. By giving their money to Mr. Greig on terms that it would be returned to them at a later date with interest, the Claimants ceased to have day-to-day control over the management of their money. Therefore, s.235 (2) does not apply.

181. S.235 (3) contains two alternatives, either of which is sufficient. Thus, paragraph 235 (3) (b) operates irrespective of whether there is any pooling: see *Asset Land* at [96].

182. There is some uncertainty, in my view, as to whether 235 (3) (a) applies. The fact that the contributions were in fact pooled in the Midas account is not determinative, since *Asset Land* requires focus on the arrangements prospectively rather than upon what may later have happened. Furthermore, section 235 (3) (a) requires pooling of both contributions and the profits or income. On balance, however, I consider that s235 (2) (a) is satisfied. Although there was a high level of generality about the arrangements as explained to the Claimants, the basic idea was that a scheme existed under which members of the scheme would pay money to Mr. Greig/Midas, and that this would be given with other scheme monies to the RBS who would then be able to pay substantial rates of interest back to Mr. Greig to be passed back to members of the scheme. The participants would have understood, at least if they had thought about it, that when they wrote cheques payable to "Midas Aberdeen" or "Midas Financial", or some similar designation, there were other participants who would be doing exactly the same; that

the money so gathered would then be paid to RBS under the arrangements which the investors understood to exist; and in due course payments would be made by RBS and ultimately to the investors back via the same route. Whilst I was not persuaded that the word "pooling" was ever used, the arrangements did in my view involving pooling both of contributions and profits and income.

183. But even if that conclusion were wrong, I nevertheless consider that this is a case where s.253 (3) (b) applies. For the purposes of s.235, either Mr. Greig or MFSS (who issued the receipts for the money and undertook to repay) was the operator of the scheme, and all the property (i.e. the money) paid into the scheme by the Claimants was to be, and was in fact, managed by one or other of them. Mr. Cutler, for example, was cross-examined on the basis that the scheme was being run by Mr. Greig:

> Q: But in terms of who was running the scheme, it was Alistair Greig , wasn't it?
> A: Yes.

I say here that it was either Mr. Greig or MFSS, without expressing a view at this stage on the question of whether this was Mr. Greig's scheme or an MFSS scheme. (This is an issue relevant to vicarious liability, which I address in Section K below). For the purposes of the application of s.235 it does not matter whether the operator was Mr. Greig or MFSS.

184. Accordingly, the scheme in my view falls squarely within the language of s.235 (1) and is not caught by any of the exceptions. However, the need for a "cautious" approach, and to avoid interpreting the section so as to include matters which are not fairly within it, means that it is necessary to stand back from the detailed analysis and ask whether this scheme can fairly be regarded as being within the section. I see no reason why not, and every reason why it should be. I do not think that there is any significant difference between a situation where a person promotes a scheme for making healthy returns by the operator's skill in betting on football matches (*O'Neal v Gale*) or, as here, promotes a scheme for making healthy returns by reason of the operator's personal relationship with the RBS. In *Asset Land*, in the context of the argument about management and control, Lord Sumption explained that s.235 covered the case where an investor "and other investors surrender control over their property to the operator of a scheme so that it can either be pooled or managed in common, in return for a share of the profits generated by the collective fund". In my view, this is in substance what happened here; with investors being made aware of a scheme, operated by Mr. Greig or MFSS, under which money could be gathered in and given to the RBS, thereby enabling high fixed rates of return to be paid.

185. This leads to the final question, namely whether the arrangements fall within paragraph 6 of SI 2001/1062. This provision has been considered in a number of authorities, and in particular the decision of Laddie J. in *The Russell-Cooke Trust Company v Elliott*. *Walker & Purves* summarise the law as follows at paragraph 22.44:

> "The use of the singular 'him' is clearly significant and Hamblen J summarised the exemption in *Andrew Brown v Innovatorone Plc* by saying that it applies where 'money in the account is held on the understanding that an amount representing the contribution of each participant is to be applied only for the benefit of that participant, as opposed to being applied for the collective benefit

of more than one participant'. He gave the example of a solicitor's client account. In *Financial Services Authority v Fradley,* the money was applied in placing bets for participants and it was held that this did not fall within any of the three 'uses' set out above"

186. The reference to *Fradley* in that passage is to the first instance decision of John Martin QC, sitting as Deputy Judge [2004] EWHC 3008, where he held that a bet was neither 'property' nor a provision of 'services' within (iii). This aspect of his decision was not challenged on appeal. The relevant part of his judgment, which also cites Laddie J's judgment in *Russell Cooke*, is as follows:

> [30] Mr Fradley's contention was that the scheme came within this provision because under the scheme terms the participators' interests were solely in relation to the communal account, and money from that account could be applied only in placing bets, in paying the scheme operator's fees and charges, and in repaying money to the participators. I do not accept this contention, for two reasons.
>
> First, subparagraph (b) identifies exclusively the purposes for which the contributions may be applied: if they may be applied for any other purpose the exception does not apply. In the present case, money in the account may be applied in placing bets; and that does not seem to me to fall within any of the three categories of payment in subparagraph (b) . It is self-evidently not within category (i); and it is not within category (ii), since the bet is not in discharge of any pre-existing obligation. That leaves category (iii); and it is not within that category because a bet is not property … nor a provision of services to the participant.

187. In *The Russell-Cooke Trust Company v Elliott and others*, Laddie J. described the provision in the Financial Services Act, equivalent to paragraph 6, as follows:

> [34] … What paragraph 35(d) is directed to is excluding from the regulatory regime which applies to CISs the funds which exist in nearly all solicitors' clients' accounts and are waiting there to be used exclusively for each client in relation to his instructions. For example, solicitors having a conveyancing practice normally hold in clients' account on a temporary basis sums from different clients for purchase of homes for each of them. This paragraph is designed to ensure that such temporary co-residence does not fall within the CIS provisions. To achieve this the paragraph provides that the money is held in the account:
>
>> "… on the understanding that an amount representing the contribution of each participant is to be applied in making payments to him or in satisfaction of sums owed by him or in the acquisition of property for him or the provision of services for him".
>
> [35] All the work in this provision is done by the words "to him", "by him" and "for him". In this legislation the distinction between the singular and the plural is important. A distinction must be drawn between sums held in a

> common account to be used for making payments on behalf of "them" — that is to say, all the persons whose money is in the account — and sums held for making payments on behalf of "him", that is to say the individual. In the former case, the account is common both as to what it contains and as to what it will be used for. In the latter, it is only common in the first sense. The co-residence in the account of sums from different individuals may be an administrative convenience, but it does not mean that those individuals are clubbing together to make a common investment. It is only common investments with which the statutory provisions are concerned."

188. It is easy enough to apply paragraph 6 to the ordinary situation of a solicitor's client account, where money will be paid by an individual to a solicitor for example for the purchase of a house and also to cover the solicitor's fees. The monies to be disbursed by the solicitor to the vendor of the house will be applied "in the acquisition of property for him" and will therefore come within (iii). The monies disbursed for past solicitor fees will be "in satisfaction of sums owed by him" (within (ii)), and the money on account for future fees will be "the provision of services to him" (iii). Equally, the understanding that the money will be returned, if the transaction falls through, or if there is a balance remaining, will come within (i): "in making payments to him".

189. I do not think that the facts relating to the payment of the monies by the Claimants to Mr. Greig can be brought within paragraph 6. There is no analogy between the payment of monies by the Claimants to the "Midas Financial" account and monies paid into a solicitor's client account. The monies were given to Mr. Greig or his colleagues on the basis he was operating a scheme whereby various participants would give money to him, and this money would find its way to the RBS, and RBS in due course would repay the money together with enhanced rates of interest. I do not think that there was anything in this arrangement which brings the case within paragraph 6 (b) (i) – (iii).

190. As Mr. Martin QC correctly stated in *Fradley,* sub-paragraph (b) identifies exclusively the purposes for which the contributions may be applied: if they may be applied for any other purpose the exception does not apply. It seemed to me sub-paragraph (b) could only apply if the case could be brought within (iii). But it was not clear to me how it could be said that the contribution of each participant was to be applied "in the acquisition of property for him or the provision of services to him". The arrangements did not seem to me to involve either the acquisition of property or the provision of services. But in any event there was nothing in the arrangements which had the individual quality ("to him") required by paragraph 6 (b) (iii). It seems to me that the arrangement was that Mr. Greig was collecting money on behalf of all the participants in the scheme, and this money was to be applied for making payments to RBS on behalf of "them". The account was therefore, to use the words of Laddie J., "common both as to what it contains and as to what it will be used for".

191. Further, the fact that the money was misappropriated by Mr. Greig after being collected together is not relevant to the application of paragraph 6, which is concerned with establishing the "understanding" as to how the amounts representing the contributions of participants are to be applied.

192. Accordingly, if (contrary to my conclusion on the threshold issue) I had concluded that section 39 had any application in the present case, I would have concluded that the scheme was a CIS, and that paragraph 6 of SI 2001/1062 does not apply.

I: Actual and apparent authority

The Claimants' submissions

193. The Claimants contended that there was a route to liability based upon actual authority or apparent authority. To a very large extent, these arguments (which were themselves interrelated) were related to the Claimants' case based on s.39 FSMA. They were deployed in order to meet the possibility that the court might conclude that the scheme was not a CIS and was simply the activity of accepting deposits. If the court were to draw that conclusion, then the Claimants nevertheless contended that advice given in connection with the scheme would fall within the actual authority of MFSS under the ARA, and therefore within the scope of s.39. Mr. McMeel therefore submitted in closing that if the scheme was not a CIS, then advising on deposits fell within the statutory contract for which Sense accepted responsibility, and in any event common law actual authority.

194. As far as concerns general principles, the Claimants relied upon *Jackson & Powell on Professional Liability* 8th edition, paragraph [15-027] where the authors state:

> An agent has implied authority to do whatever is necessary for, or ordinarily incidental to, the effective execution of his express authority in the usual way. This has two consequences. First, while the terms of an appointed representative's express authority might be limited to providing investment advice to customers in relation to particular products of his principal, conduct that is incidental to the provision of that advice (such as soliciting the customers, identifying the financial and personal circumstances of the particular customer, assisting in any application that the customer might choose to make) will still fall within the actual authority of that representative. Hence in *Martin v Britannia Life Ltd*, the representative was authorised only to give advice in relation to "investments" issued by the defendant. However, he also gave mortgage advice (a mortgage of real property (then) not being an "investment"). It was held that he had actual authority to give such advice since the advice was inherently bound up with and incidental to the advice given by him in relation to the other investments. Secondly, irrespective of whether or not the agent has actual authority to act on the principal's behalf in the relevant way, a principal will be bound by such acts of an agent if the agent has ostensible or apparent authority to act in that way. Thus, if a firm has knowingly or even unwittingly led a customer to believe that an appointed representative or other agent is authorised to conduct business on its behalf of a type that he is not in fact authorised to

> conduct, the firm will be bound by the acts and omissions of the agent and will be liable for his defaults.

195. As far as actual authority was concerned, the Claimants relied upon the authority conferred under the AR Agreement to provide "Additional Services", namely: "providing or offering or agreeing to provide, a service of a kind that is often provided by an independent financial adviser". The Claimants contended that although advising upon or arranging deposits (such as ordinary deposits at high street banks or cash ISAs) are not regulated activities under s.19 and 22 of FSMA and the RAO, so that any person can do it, nevertheless this was something that independent financial advisers ("IFAs") may commonly do; for example, advising the recipient of a substantial sum by way of inheritance to put a percentage away in an easily accessible form. Traditionally, IFAs may not have been attracted to giving advice on such deposits; because it has not been remunerated by much, if any, commission. However, the ARA should be read as permitting and authorising advice on such non-investment savings products, either because it was an "Additional Service" under the ARA, or because of actual authority at common law, or both.

196. As far as apparent authority was concerned, the Claimants contended that advising on savings or other deposit schemes was integral, additional or ancillary to their role as IFAs, even though no authorisation or exemption was required under FSMA to carry out these activities. The principal focus of the case on apparent authority was the representation which MFSS had made as to their status on the stationery which had been approved by Sense:

> Midas Financial Services (Scotland) Ltd. is an appointed representative of Sense Network Limited, which is authorised and regulated by the Financial Services Authority.

197. The Claimants recognised that this form of "status disclosure" is a regulatory requirement, and is therefore compulsory. Nevertheless, they argued that it had long been recognised that the aura of authority or "badge of respectability" conferred upon both a directly authorised firm, or upon an AR, by the compulsory status disclosure, and by the use of stationery and business cards, is relevant to the apparent authority of individual advisers, and will induce trust and reliance in prospective customers.

198. In addition to the status disclosure at the foot of the letters sent to the Claimants confirming their deposits (both when initially made, and when rolled over), the Claimants contended that MFSS's advisers would have been trained to carry out status disclosure at meetings with prospective clients, and that the court should conclude that such disclosure was also made to those claimants who engaged in both regulated business (such as mortgage and pensions) and the scheme. The court should also infer that such disclosure took place to those other claimants who simply participated in the scheme.

199. Against this background, the Claimants relied upon what they described as the "leading case" of *Martin v Britannia Life Ltd.* in support of the argument that MFSS and its advisers had apparent authority to advise upon the scheme. Particular reliance was placed upon the passage at page 428 of the judgment where Jonathan Parker J. relied upon the business card, approved by the principal, and presented by the representative to the client. The judge held that this card, which described the representative as a

"financial adviser", was a representation that he was authorised to give advice in relation to the "the sale of insurance, including advice concerning associated or ancillary transactions … In particular, it represented that Mr. Sherman was authorised by LAS to advise on the package of transactions which, in the event, he recommended". The Claimants contended that business cards were in all likelihood supplied to all claimants in the present case.

200. However, the Claimants' argument on ostensible authority went even further. The Claimants submitted that the status disclosure at the foot of the letters was sufficient to found a case of ostensible authority in relation to everything that the adviser did, and certainly for everything done which would fall within the usual authority of a financial adviser. Mr. McMeel submitted that every time a network equips an appointed representative firm with the letterhead and status disclosure, and with business cards, "it follows that they are the ultimate defendant".

201. In addition to the status disclosure on the MFSS stationery, the Claimants referred to a 4 page MFSS brochure which one of the Claimants, Mrs. Baylis, had retained. In addition to the status disclosure in that letter, the brochure stated that MFSS offered advice on "the entire range of investments and savings options". This supported the case that advice on cash ISAs and other deposits would be within the ostensible and usual authority of MFSS. In summary, the brochure, the stationery and the business cards were all part of the overarching status disclosure which gave the badge of respectability to MFSS.

202. Although these arguments based on actual or apparent authority were advanced in conjunction with s.39, and as a further reason why s.39 should apply, they (and particularly the argument on apparent authority) were also advanced as a route to liability independent of s.39. The argument in that connection was essentially that representations made in connection with the scheme were made with the actual or apparent authority of Sense, and that tortious liability at common law would result.

Sense's submissions

203. Sense submitted that advice about/ the operation of the scheme was not authorised business for the reasons given in responding to the case on s.39 FSMA.

204. In relation to ostensible authority, Sense submitted that this could only come arise if the following conditions had been satisfied:

i) Sense had held out MFSS as being authorised to promote the scheme;

ii) The Claimants had relied on the principal's holding out to conclude that they were dealing with the agent as such;

with consequence that

iii) Sense as principal became liable for the acts and omissions of MFSS as its agent.

Sense submitted that neither of these key requirements, leading to that consequence, had been fulfilled.

205. As far as the requirement for a relevant representation was concerned, Sense submitted that the footer on the notepaper (or equivalent "status disclosure" in any other documents or meetings) was not a representation of any kind to the effect that MFSS was running the scheme with the authority of Sense or as the agent of the Defendant. This wording was simply a mandatory requirement of the regulatory regime.

206. Thus, every AR in the country carries details of its network firm on the footer of the notepaper that it uses for authorised business. If that statement amounted to a sufficient representation to found a case of ostensible authority, it would follow that a client who received a letter on that letterhead would be able to sue the principal in every case: including cases where the principal had not given written authority to the AR to conduct the relevant business. Thus, the consequence would be a liability on the network for any communication of whatever type made on the notepaper. It would be a very surprising proposition that the network would be liable for any communication made on notepaper which had to contain the "status" wording. It would also mean that section 39 would be redundant, because the liability which would attach from the use of the notepaper would be wider than that imposed by the section (since the limitation that the principal must have authorised the relevant business would not be in play).

207. Sense also submitted that the decision in *Martin* provided no support for the case of ostensible authority. The key facts, and the representation relied upon, were entirely different.

208. As far as reliance was concerned, Sense submitted that the Claimants did not rely on any representation as to the role of Sense or the authority of MFSS to act for Sense. In that connection, Sense relied upon a number of matters as supporting the case that there was no reliance:

i) Each of the Claimants had deposited money in the scheme without a single document being provided to them in connection with it, before parting with their money. This was fatal to any argument of ostensible authority based on the letterhead, because it shows that the Claimants could not have relied on the terms of the footer.

ii) Seven of the Claimants candidly stated that they had never heard of Sense or did not think to complain to Sense following the collapse of the scheme.

iii) Other Claimants who asserted some reliance on Sense still did not make a complaint to Sense following the collapse of the scheme, and this afforded powerful evidence that they did not rely on any involvement of Sense before electing to deposit money.

iv) The Claimants generally paid no attention to the wording of the letters. Hence none of them was able satisfactorily to explain why they did not challenge the "execution only" wording in the letters in circumstances where most of them contended that they had received advice. The only part of the letter which was of any significance to them was the statement as to when and how much they would be paid.

209. Sense also submitted that the Claimants had in fact relied upon other matters in deciding to invest their monies. These were:

i) Trust reposed by them in the individual adviser by reason of family relationships or previous dealings;

ii) Investment by other family members, or friends, within the scheme;

iii) The involvement of RBS within the scheme;

iv) The alleged existence of FSCS compensation;

v) The evidence from some witnesses that in Aberdeenshire business is conducted on the basis of local connections and trust in those who are "local".

Analysis and conclusions

210. In my judgment, the arguments based on actual and ostensible authority, whether advanced in conjunction with s.39 or as self-standing points, fail.

211. As far as actual authority is concerned, the argument fails for essentially the same reasons which led to my conclusion (in the context of s. 39) that the scheme, and advice in connection with that scheme, were well beyond the scope of the "business" for which Sense accepted responsibility pursuant to the ARA. There was no relevant "Company Agency", and for that reason alone there is nothing in the ARA which conferred any relevant actual authority on MFSS. Furthermore, as I have already stated, it is impossible to construe any provision of the AR agreement as authorising MFSS to advise on or arrange investment in what was an illegal scheme and one which involved MFSS taking and holding client money. The taking and holding of client money was directly contrary to the express terms of the ARA.

212. As far as apparent authority is concerned, it is clear from the decision in *Martin* (in particular paragraph 5.3.3) that, in order to establish apparent authority, it is necessary for the claimants to establish a representation made by Sense, which was intended to be acted on and which was in fact acted on by the claimants, that MFSS was authorised by Sense to give advice in connection with the scheme.

213. In the present case, the MFSS was promoting a scheme which it was itself operating. The evidence in the case (to which I have already referred) clearly demonstrated, for obvious reasons, that the usual activity of a financial adviser does not include running a deposit scheme. It logically follows, in my view, that the usual activity of a financial adviser does not extend to advising on such a deposit scheme. There was in my judgment no representation made by Sense that can be spelt out of the MFSS stationery, or any of the other matters relied upon by the Claimants, that MFSS had any authority to take deposits, or to give advice to clients in connection with the deposit-taking scheme that they were running. Indeed, four of the Lead Claimants who maintained a case of reliance (Mrs. Baylis, Mr. Mackenzie, Mrs. Shepherd and Mr. Lucas) dealt with MFSS in relation to regulated products, and were therefore aware of or signed documentation which expressly provided that MFSS could not handle client money or accept cheques made out to MFSS. In my view this in itself is fatal to any case of ostensible authority in relation to such claimants.

214. There is therefore no foundation for any case of ostensible authority, which depends upon a relevant representation being made by the principal.

215. It may possibly be the case that an IFA would have apparent authority to give advice in relation to the making of deposits at High Street banks, or as to the benefits of taking a cash ISA. The evidence indicated that this was not something that IFAs typically did, not least because: (i) information as to savings rates is widely available in, for example, the national press, and (ii) no commissions are paid by High Street banks to IFAs for arranging deposits or cash ISAs, and therefore it is not something that IFAs are interested in doing. However, the present case did not involve the Claimants making deposits at High Street banks or taking out cash ISAs, or receiving advice in relation to such products. None of the Claimants received any documentation from the RBS, or provided any documentation (e.g. for identification purposes) to RBS, even though RBS was frequently referred to (as described above) as part of the sales pitch. The only contractual documentation that any Claimant received was the letter from MFSS itself. This contained the commitment by MFSS (not the RBS) to pay. The only documentation which a Claimant provided was a cheque which was payable to "Midas Financial" (or some similar designation), not to the RBS. This was therefore a case where it must have been apparent to the Claimants at the time, and not simply with the benefit of hindsight (as Mr. McMeel sought to suggest in closing), that this was a deposit-taking scheme which MFSS itself was operating.

216. I also agree with Sense that there is nothing in the "status" disclosure – i.e. the compulsory wording relating to the status of MFSS and Sense appearing at the foot of the stationery and elsewhere – which can be read as containing any relevant representation as to MFSS's authority to do what they were doing in this case: i.e. running the scheme and advising in relation to it. The "status" disclosure did no more than identify the regulatory status of MFSS and Sense and the relationship between them. I did not consider that the Claimants had provided any persuasive reason as to how the statements on which they relied relating to "status disclosure" could lead to the conclusion that MFSS was authorised to provide advice on the scheme that was being promoted. In my view, a case of ostensible authority requires much more than an assertion that Sense conferred a "badge of respectability" on MFSS. As *Martin* shows, it requires a representation that there was authority to give advice of the type that was given. Similarly, the above passage from *Jackson & Powell* shows that the relevant question is whether the firm has "knowingly or even unwittingly led a customer to believe that an appointed representative or other agent is authorised to conduct business on its behalf of a type that he is not in fact authorised to conduct".

217. I also agree with Sense that it would be a very surprising conclusion if the compulsory status disclosure meant that Sense were liable for, in effect, whatever was then written on the notepaper by MFSS. This seems contrary to the principles developed in the cases relating to ostensible authority, such as *Martin*, which require analysis of the nature of the representation made. I also agree with Sense that this conclusion would have the surprising effect of imposing liabilities on Sense which go well beyond the liability which arises under s. 39; since it would eviscerate the requirement in s.39 that the principal accepts responsibility for the relevant business.

218. Nor is there any analogy with the facts or conclusions in *Martin.* That case was not concerned with any representation alleged to arise from "status" disclosure. In *Martin,* the representation by the principal that the agent was a financial adviser acting for an

insurance company was regarded as a sufficient representation that the adviser could advise on matters (the mortgage in that case) which were ancillary to insurance products. In the present case, there is nothing in the "status disclosure" which contains any representation that MFSS or its financial advisers could operate or advise in connection with a deposit scheme that MFSS was running.

219. Accordingly, the case on apparent authority does not get to the first base of establishing a relevant representation. This means that it is not necessary to consider in detail the factual question of whether there was sufficient reliance by the Claimants upon a relevant representation by Sense. I will, however, state my factual conclusions on this issue in case I am wrong on the question of whether there was a relevant representation.

220. There was no dispute that a relevant ingredient of a case based on apparent authority is reliance on the faith of the representation alleged: see *Bowstead and Reynolds on Agency* 21st edition, paragraph [8-010] and [8-024]; *Martin* paragraph 5.3.3. In *Martin*, Jonathan Parker J. held that the relevant representation in that case (namely that the adviser was authorised to give financial advice concerning a remortgage of the property) was acted on by the plaintiffs "in that each of them proceeded throughout on the footing that in giving advice Mr. Sherman was acting in every respect as the agent of LAS with authority from LAS so to act".

221. The issue of reliance in the present case concerns only 6 of the lead Claimants:; Mrs. Baylis; Mr. MacKenzie; Mr. Lucas; Mrs. Hutchinson; Mr. Rognaldsen; and Ms. Shepherd. This is because it was accepted by the Claimants, in closing submissions, that there was insufficient evidence of reliance by the other lead Claimants (Mr. Ross; Mr. Lee; Mrs. Liddell; Mr. Masson; Mr. Ansell; Mr. Creighton), most of whom acknowledged that they had not heard of Sense.

222. The question of reliance must in my view be approached on the basis that, contrary to the conclusion which I have reached, there was a representation by Sense that MFSS was authorised by Sense to give advice in connection with the scheme, such representation being contained in the "status disclosure" set out in the footer to the confirmation letters which all of the claimants received, or (in the case of Mrs. Baylis) the 4 page brochure that was received. (None of the Lead Claimants gave any positive evidence about any status disclosure having been made on other occasions or in any other documents, or reliance thereon). The question is therefore whether each of the remaining 6 claimants in fact acted on the faith of a representation to the effect that MFSS was authorised by Sense to give advice in connection with the scheme. I agree with the Claimants that if a claimant relies upon a combination of factors, including the relevant representation, a sufficient case of reliance for the purposes of apparent authority would be made out. Nevertheless, I was not persuaded that any of the Claimants relied upon a representation that MFSS was authorised by Sense to give advice in connection with the scheme.

223. First, the fact that many of the Lead Claimants acknowledged that they had never heard of Sense is unsurprising given the way in which the investment in the scheme came about. This was a scheme which was being operated and advised upon by people in Aberdeen, and who were working from the office of MFSS which was located there. The evidence of the Lead Claimants, time and again, referred to the trust that they placed in the individuals at MFSS with whom they were dealing. In many cases there was a long-standing business or family relationship between the MFSS advisers and the

claimants. The Lead Claimants in my view approached the investment on the basis that they were dealing with the representatives of a local Scottish advisory firm (MFSS), rather than representatives of Sense.

224. Secondly, and consistent with the previous point, I agree with Sense that it is significant that 6 claimants who alleged reliance (as with all the Lead Claimants) gave their money to MFSS, at the outset, without seeing the footer on the acknowledgment letters. The acknowledgment letters were only received some time after the money was handed over. This suggests very strongly that none of these claimants was relying upon any connection between MFSS and Sense, and indeed that they were willing to advance monies without knowing about Sense. It is true that these claimants did subsequently roll-over their deposits, and that by that time they had received the acknowledgment letters referring to Sense. However, I agree with Sense that the part of the acknowledgment letters that mattered to these claimants was the part setting out the amounts to be repaid and dates of repayment, rather than anything that was said in the footer or elsewhere in the letters. Thus, none of the claimants sought to query the reference in the confirmation letters to "execution only basis, that is no advice was given or sought", notwithstanding that many of them considered that had indeed received advice.

225. Indeed, it seems to me that the reality is that this was a scheme which was promoted, and in which investors invested, as a result of word of mouth rather than documentation: there was no brochure describing the scheme, no documents given prior to investment, no documentation referring to the involvement of RBS or the FSCS, which many investors were told about. Against this background, I was doubtful as to whether any of the Lead Claimants had really relied upon the status disclosure contained in the footer to the confirmation letter or elsewhere.

226. Thirdly, none of these claimants appear to have asked the MFSS financial advisers any questions about who Sense were, or to explain what was meant by the disclosure in the footer. Despite the relative ease of doing so, none of the Lead Claimants, apart from Mr. Rognaldsen, carried out any internet search of Sense in order to find out more about them. This fact reflects my earlier conclusion that the claimants were dealing with various individuals who were understood to represent MFSS, a local firm. Personal trust in the MFSS individuals with whom the claimants were dealing, and in many cases knowledge that others had benefited from the scheme in the past, provides a ready explanation as to why they were willing to hand over very significant sums of money, and to do so without signing or receiving, at least at that time, any documentation; still less any documentation referring to Sense.

227. Fourthly, it seemed to me that the evidence of the 6 individuals generally went no further than an assertion that they drew the conclusion that MFSS was a legitimate firm, with regulation by the FSA. Similarly, Mr. Rognaldsen's evidence went no further than showing that he understood that Sense was a properly regulated firm (which it was). This seemed to me to fall short of establishing reliance on the representation that was needed; namely that that MFSS was authorised by Sense to give advice in connection with the scheme.

228. Turning to the detail of the evidence given by each of the individual claimants, I do not consider that any of them demonstrated that they relied upon any relevant representation by Sense.

229. *Mrs. Baylis* made her decision to invest based upon her trust in Mr. Laing, who was an old friend both of Mr. and Mrs. Baylis. Mr. Laing was the best friend of her brother at school. She described a close and trusting relationship between her and her husband and Mr. Laing. She was one of the claimants who received a terms of business letter in 2009 (in connection with a proposed mortgage) stating: "Midas Financial Solutions (Scotland) Ltd. is not permitted to handle client money and we cannot accept a cheque made out to us (unless it is an item for which we have sent you an invoice) or handle cash". Her evidence indicated that she did not pay any attention to that statement. I do not consider that she paid any greater attention either to the wording in the footer of the confirmation letter, or to the similar wording in the brochure which she skim-read.

230. Her oral evidence was that the small print at the bottom of the letter shows that "you have a bit of protection with the Financial Services Authority". She then explained that she thought that the protection was from both the FSA and Sense: "It looks like there are two people that are looking after the place". This evidence seemed to me to concern Mrs. Baylis' understanding of the regulatory system and the protection that it provided, rather than establishing that Mrs. Baylis relied on a representation that MFSS was authorised by Sense to give advice in connection with the scheme.

231. For these reasons, I do not consider that Mrs. Baylis' evidence established reliance by her on the representation which needs to be established for the purposes of apparent authority.

232. *Mr. MacKenzie's* decision to invest was based upon his long-standing relationship with Mr. Milne which dated back to Park Row, and the trust that he had in Mr. Milne. Mr. MacKenzie had bought pensions, insurance, ISAs and other products over the years. He described a "good and trusting relationship", and referred to that "trust" at many stages in his evidence. He was told by Mr. Milne that the scheme was something he could not afford to miss, and that other professionals had invested. He was not sceptical about this because, as he explained in his witness statement: "I had a relationship of trust with Allan". Mr. MacKenzie had some difficulty explaining why he did not challenge the "no advice was given or sought" part of the confirmation letter, stating that he did not take much notice of it "but my confidence came from dealing with my adviser".

233. Mr. MacKenzie did some research into MFSS on the internet. He concluded that everything seemed normal: "It appeared that Midas were properly regulated by the FCA under the Sense network umbrella which gave me added peace of mind". He did no research into Sense. When he discussed the scheme with Mr. Milne, he did not ask Mr. Milne any questions about Sense. The questions which he did ask were directed towards whether the scheme was regulated and whether there was a government guarantee.

234. In the light of these facts, I was not persuaded that Mr. McKenzie relied upon the representation that needs to be established. It seems to me that he relied upon the trust that he placed in Mr. Milne, and his assurances that the scheme was regulated and was operated by the Royal Bank of Scotland. I accept that, as a result of his internet research, he was aware that of Sense prior to his investment in the scheme. But his understanding was simply that an understanding as to regulation, rather than whether MFSS was authorised by Sense to give advice in connection with the scheme.

235. *Mr. Lucas* was a long-standing client of Mr. Knowles, also dating back to Park Row. He had a meeting with Mr. Greig at some point between 1 April 2007 and January 2008, when the scheme was discussed. Mr. Lucas was "reassured by the charismatic presentation of the scheme by Alastair and by the fact that he was a properly regulated financial adviser with whom I had established business". According to Mr. Lucas' evidence, Sense was briefly referred to at the meeting: Mr. Greig told Mr. Lucas that Midas was an appointed representative of Sense, and that Sense were also regulated by the FSA. He was also told that since the money was deposited with the RBS, it would be covered by the FSCS up to £ 85,000. As a result of these assurances, Mr. Lucas said that he understood that his money would be protected.

236. Mr. Lucas was in my view a witness whose evidence was clearly influenced by the litigation in which he was participating. For example, he was clearly conscious of the arguments in the case concerning CIS, and was therefore keen to make the point in his oral evidence that the deposit account arrangement was a "collective investment". Similarly, his evidence in relation to the confirmation letter was that the small print on the bottom "confirmed what I had been told, that it was a regulated investment". I thought that this answer, too, was coloured by the arguments that were being advanced in the case. The footer does not say that the investment was a regulated investment, and I do not accept that Mr. Lucas drew that conclusion.

237. I also do not accept Mr. Lucas' evidence that Sense had been discussed at his initial meeting with Mr. Greig. In his Statement of Case, Mr. Lucas had said that this meeting took place in March/April 2007. His witness statement was to the same effect, identifying the relevant meeting as around April 2007. An email dated 24 April 2007 was referred to as having been sent <u>after</u> the meeting at which Mr. Lucas had been "reassured by the charismatic presentation of the Scheme by Alistair". In his evidence in chief, however, he made corrections to both documents, so as to place the meeting at some point between April 2007 and January 2008. The significance of this change was that if the meeting had happened in April 2007, there would have been no discussion of the relationship between MFSS and Sense, because it had not yet started: MFSS only became an AR of Sense in September 2007.

238. As with Mr. MacKenzie, Mr. Lucas had difficulty explaining why he did not challenge the "no advice was given or sought" part of the confirmation letter. His explanation was that "it didn't really concern me, because I was dealing with people I trusted and, as I say, it was a regulated company". Nor did Mr. Lucas apparently pay any attention to the terms of business letters which he was given, which included the statement that MFSS "is not permitted to handle client money …"

239. When asked about the footer, Mr. Lucas said that he was "relying on the fact that I'm dealing with a reliable company in Midas who had been advising me for a number of months before that, and who I had known – they were the advisers from Park Row who moved across to Midas I had had colleagues who had done business with them, and quite happily. So I was assured that it was a reliable firm to do business with." I consider that this answer reflected the matters on which Mr. Lucas relied in making his investment decisions: these were based upon the trust that he placed in MFSS and its advisers. I was not persuaded that Mr. Lucas paid any attention to the footer of the confirmation letter. At best, as he said in a subsequent answer, he felt reassured that "the company itself has the appropriate regulation covering it, and authorisations". But

in my view this does not equate to reliance on the representation that needs to be established.

240. *Mrs. Hutchinson* and her husband were introduced to the scheme through a friend (Mr. Dass) who had invested in the scheme through Mr. Greig, and who had spoken very highly of it. She accepted that she had never heard of Sense before she deposited her money. Her evidence was that she was relieved to receive the confirmation letter, and "picked up that on the bottom left hand corner of this letter, it was stated that Midas was a representative of the Sense Network and regulated by the Financial Conduct Authority". In her oral evidence, however, when asked whether she had seen the reference to "regulation of Midas by Sense", she said that she "possibly noticed more the "Financial Services Authority"". She did not ask any questions about Sense or conduct any research.

241. It seemed to me that this evidence was insufficient to establish reliance on the representation that needed to be established. At most, Mrs. Hutchinson relied upon the fact that there was regulation by the FCA.

242. *Mr. Rognaldsen* was the only individual who appears to have been at all interested in Sense. He had seen a reference to Sense on a business card of the individual who had introduced him to the scheme (an old friend called George Simpson), and was told by Mr. Simpson that MFSS was regulated through the Sense Network. Mr. Rognaldsen took the trouble to do some internet research, including looking at the Sense website. He explained in his oral evidence that he was just "making sure that Sense Network was properly FCA regulated. That's so far I could go with my knowledge on regulation". It seemed to me that this evidence did not establish reliance on the representation that needed to be established. Indeed, it reinforces my earlier conclusion that the "status" disclosure did no more than identify the regulatory status of MFSS and Sense, and the relationship between them.

243. *Mrs. Shepherd* was introduced to the scheme through her brother in law, Mr. Alexander, and her dealings with the scheme involved both Mr. Alexander and Mr. Greig. She had never heard of Sense before she put the money in. In cross-examination, she accepted that her motivation for investing was (i) the reference to RBS, and her trust in RBS, and assurances from Mr. Alexander and Mr. Greig that the scheme was all right because it was with RBS; and (ii) the trust that she had in her brother in law and Mr. Greig. She accepted that these were the only two things that made her invest. When it was put to her that it was "totally irrelevant to you whether Midas or Greig or Alexander had some connection with any other company", her answer was "I am not sure". On the basis of this evidence I cannot conclude that she relied on the relevant representation.

J: Breach of Supervisory Duty: attribution of Mr. Ingram's knowledge

244. The Claimants' third route to liability was a case that Sense was in breach of the supervisory duties in SUP 12 coupled with the attribution to Sense of the knowledge, conduct and omissions of Mr. Ingram. This case did not therefore allege that the senior management of Sense (such as Mr. Netting), or indeed any of the managers within Sense itself, were personally at fault. Rather, the Claimants contended that since Mr. Ingram knew all about the scheme, and since his knowledge was to be attributed to

Sense, it necessarily followed that Sense failed in its supervisory duties by failing to take steps to prevent the scheme being operated. The central issue was whether Mr. Ingram's knowledge could be attributed to Sense. If attribution was appropriate, it was not disputed that the consequence was that there was a breach of the rules in SUP 12, and that liability under s. 150 and 138D of FSMA would arise. In this section, I describe: (i) the relevant facts relating to Mr. Ingram's role and knowledge, and (ii) the relevant provisions of SUP before turning to the detail of the parties' argument and my conclusions.

Mr. Ingram's role and knowledge

245. Mr. Ingram was an employee of MFSS, not Sense. Between 2007 and 2012, he carried out the role of T&C Supervisor at MFSS. This role was, as described below, defined for him by Sense. However, he remained an employee of MFSS and he was not remunerated by Sense for the work that he carried out as T&C Supervisor. Mr. Ingram also performed some other tasks at MFSS, including doing paraplanning (which involved giving an IFA assistance on a client file, such as report writing, research and processing of applications) for two of the advisers. His role as T&C Supervisor occupied around 2 days per week. It was his role as T&C supervisor which was the primary focus of his evidence at trial.

246. His responsibilities and key tasks in that role were set out in a document, headed "T&C Supervisor Job Role" ("the Job Role document") produced by threesixty for Sense. The key responsibilities were:

> "To undertake coaching, training assessment, monitoring and supervision of Advisers within the Sense T&C Scheme, and to liaise with the Business Development Manager (BDM) and advise of any issues.
>
> Comply with all applicable, FSA rules and requirements, relevant to the role.
>
> Ensure regulatory standards are maintained within the location in relationship to all sales made in conjunction with the Compliance requirements"

Sense's "BDM" was initially Mr. John Painter.

247. The "Key Tasks" identified in the Job Role document were as follows:

> 1. Active monitoring of each IFA/Advisers performance, utilising Key Performance Indicators (KPIs), conducting regular performance reviews/ 1-1 meetings.
>
> 2. Monitoring of an Adviser's performance via objective observation of each of the key activities of the Adviser's role in line with company procedures. Providing feedback and identifying and agreeing action plans.

> 3. Validates the effectiveness of Adviser learning by observation.
>
> 4. Provides constructive guidance, feedback and coaching to Advisers ensuring good practice and competent standards.
>
> 5. Maintains supervisory records, Training files for each Adviser. Review and sign-off of the Adviser Record of CPD.
>
> 6. Liaison with BDM to ensure appropriate training of Advisers is implemented.
>
> 7. Facilitate the education and development of PAs, Paraplanners and Researchers.
>
> 8. Conduct meetings and presentations on legislative and Sense policy changes and communicate to all employees and Advisers.
>
> 9. Facilitate or conduct training in branch for Advisers and employees as appropriate.
>
> 10. Maintains personal development as a T&C Supervisor.
>
> 11. To undertake any other duties commensurate with your grade, skills and experience.

248. In his evidence, Mr. Ingram agreed that the "Key Responsibilities" corresponded to his understanding of his role and that the "Key Tasks" gave a good summary of his role as T&C Supervisor. That evidence was consistent with the documentation examined during Mr. Ingram's evidence and generally during the trial. It is plain from the list of responsibilities that Mr. Ingram had an important role to carry out as T&C Supervisor. Sense's expert, Mr. Percival, rightly described training and competence as being a core element of compliance.

249. Mr. Ingram's role gave him access to the feedback which an adviser had received on a file review including any "remedial": i.e. remedial work identified by Sense or threesixty on Sense's behalf. It was not Mr. Ingram's role to say whether or not he agreed with the conclusions of the file review. Thus, the task of checking compliance was undertaken by Sense (or threesixty on its behalf) and Mr. Ingram would be the conduit for what Sense had decided needed to be done. Mr. Ingram's function was to assist the adviser in responding to the file review and carrying out the remedial required. Mr. Ingram would see whether the adviser needed any help, whether he understood it, whether he needed clarification, and any further relevant discussion.

250. It was the adviser, rather than Mr. Ingram, that was required to respond to Sense (or threesixty on Sense's behalf) following the review, and Sense would then look at that response, check the response against any supporting documents that had been supplied, and then provide feedback to the adviser as to whether or not the remedial had been carried out in a satisfactory manner. Mr. Ingram would see the results of this, and his coaching role would involve discussing with the adviser whether there was anything

that he could learn from the process, with a view to trying to make sure that it did not happen on future files.

251. In order to fulfil these tasks, Mr. Ingram would carry out one on one meetings (referred to as "1 to 1s" or "1-1s") with MFSS's advisers. These meetings were held on a regular basis, the frequency depending upon a rating (Red, Amber, Green) decided upon by Sense. This rating in turn depended upon the outcome of (amongst other things) its case reviews, reports from Mr. Ingram, and other information available on the I/O system. Mr. Ingram would be told the relevant grading, and would then meet monthly (for those graded Red), quarterly (Amber) or six-monthly (Green). The discussion at the 1-1 meetings was documented on a standard form and sent back to Sense.

252. The standard forms used by Sense to document these meetings changed over the years, but the broad nature of the work can be seen from an early form, headed "Development Meeting Notes". This identified in tabular form a number of topics to be addressed, including "Key Performance Indicators", "Case Monitoring", "Continuing Professional Development" and an "Action Plan". It was in the context of "Case Monitoring" that Mr. Ingram would discuss with the advisers any issues resulting from the files which had been checked by Sense or threesixty on its behalf.

253. Mr. Ingram would have no general involvement, however, in deciding which files were to be checked, save that he might suggest to Sense from time to time that a particular file was worth scrutinising. The 1-1 meeting would also involve discussion of the adviser's performance in the context of various "Key Performance Indicators" which had been selected by Sense. If there had been a complaint by a customer, it was Sense that was responsible for dealing with it. But the results of any complaint would be fed back to Mr. Ingram so that he could discuss it in the 1-1s.

254. Prior to the time when Mr. Owen took over as T&C Supervisor in 2012, it was Mr. Ingram who was carrying out the 1-1 meetings with the advisers, as well as annual reviews which were recorded on forms headed "Competent Adviser Sign Off". The completed forms were then emailed to Sense: these records of 1-1 meetings and other supervisory records were a critical source of information to Sense as to what was happening at MFSS on a face to face level.

255. As part of his work on development and coaching, Mr. Ingram would seek to ensure that advisers complied with their "Continuing Professional Development" or "CPD" requirements, and he would organise events which qualified for CPD points. Mr. Ingram would himself have development meetings with Sense. He was therefore himself supervised, as far as his T&C work was concerned, by Mr. Painter and subsequently Mr. Owen. In 2012, Mr. Ingram ceased to perform the role of T&C Supervisor, at least as far as the Aberdeen office was concerned. Instead, Mr. Owen – who worked for Sense in its office in Knutsford, Cheshire – took over. During the course of 2012, Mr. Owen went to Aberdeen on 10 occasions (nearly every month), and held various 1-1 review meetings as well as attending training sessions and doing other work.

256. An aspect of Mr. Ingram's coaching role was to sit with an adviser, either with a live client, or in a role play situation, and make sure that the adviser was doing all the things that he should have been doing. Mr. Ingram would thereby observe the process and make sure that the advisers were conducting the process properly. For this purpose,

Sense provided forms which covered what the adviser should be saying, and Mr. Ingram would tick the boxes to make sure that the adviser was doing everything which he should have been doing.

257. Mr. Ingram was not involved in compliance policy making or high-level decision making for Sense. He was described by the Claimants as part of a "triumvirate" comprising Mr. Netting and Mr. Painter (subsequently Mr. Owen). The word "triumvirate" suggests that Mr. Ingram occupied a position of power in conjunction with the other two people, but in my view this considerably overstates his role and position. His work essentially involved the implementation of Sense's decisions on file reviews and other policy or decisions taken by Sense, and accordingly was responsive to what Sense told him to do. It was also supportive of the work carried out by the advisers at MFSS. The Claimants submitted that he was involved in the operational dimension of compliance, and this is a fair description. There was, as Mr. Netting said, reliance by Sense upon Mr. Ingram properly to assist the MFSS advisers to comply with Sense's procedures and to inform Sense when that was not the case. Mr. Netting described him as Sense's "man on the ground", and a conduit for communications regarding file checks, complaints and other matters. Mr Owen described him as a coach for the advisers, to a certain extent Sense's 'man on the ground', and as a conduit for communications. In his oral evidence, Mr. Owen described the role of Mr. Ingram, and other T&C supervisors in the Sense network, as "additional eyes and ears on the ground". Mr. Netting accepted that "in some ways" he was Sense's eyes and ears at Midas. He said that Mr. Ingram "did obviously point things out to us where he established concerns or so forth. But he wasn't our only eyes and ears".

258. There were, naturally enough, many things that lay beyond Mr. Ingram's role, including the selection of files for review, the performance of file review checks, any decision to impose sanctions on defaulting advisers, complaints handling and decisions on complaints, setting key performance indicators, and making the final decision on what grade (Red Amber or Green) to give an adviser.

259. The Claimants case was opened on the basis that Sense "left everything up to Mr. Ingram". The evidence showed, however, that this was a considerable overstatement. In very general terms, it could be said (as the Claimants' submitted) that Mr. Ingram occupied a role within Sense's overall compliance architecture. But the nature of that role and its limits were as described above.

260. As far as Mr. Ingram's knowledge of the scheme was concerned, there was no dispute that Mr. Ingram knew all about the scheme, and indeed introduced some investors to it, including one of the lead claimants, Mr. Masson. He had known about the scheme since around 2003/4 when he was at Park Row, and he knew that it had continued after MFSS had started in business. In his whistleblowing e-mail dated 7 August 2014, he described the following:

> "For the last number of years Alistair Greig has been running an unauthorised 'short term deposit' investment for clients. The investment is in a Royal Bank of Scotland bank account, clients simply write a cheque to 'Midas Aberdeen' and get a guaranteed return after a number of months. Letters confirming their investment and the return they are to expect are sent to clients on Midas headed paper. Advisers are paid commission for 'selling'

> this investment. This is not the Midas Financial Solution (Scotland) Ltd. bank account, but another maintained by Alistair with a similar name.
>
> The whole investment is overseen by Alistair, but over the last 1-2 years has been administered by Christine Dowall. All letters are typed on her computer in the Midas office and she keeps a large lever arch file.
>
> Midas Advisers involved are: Alistair Greig, Ian Towe, Allan Milne, John Cutler, John Ross, David Laing. Ex adviser Kevin Alexander is also involved. I have until very recently had clients with some funds in this, but have removed them all …"

261. Mr. Ingram explained in evidence that his reference to "unauthorised" meant not authorised by Sense. He was aware that the scheme was not a regulated or approved product and involved MFSS advisers soliciting and receiving client moneys in breach of regulatory requirements.

The relevant rules and guidance in SUP 12

262. SUP 12 has an internal hierarchy of "Rules" and "Guidance" (denoted commonly adding by "R" after a Rule, and "G" after Guidance). Breach of the statutory rules (but not guidance) has two consequences: (i) public law consequences, including fines or public censure under s. 205 and s.206 of FSM; and (ii) the private law consequence of actionability under s.150 (or s. 138D with effect from 1 April 2013 in respect of FCA rules).

263. Accordingly, breach of a rule in the FSA/FCA Handbook creates what the Claimants described as a "mini-tort". The origin of what is now s.138D can be seen in the reports by Professor Gower: essentially it was designed to strengthen consumer protection by providing a remedy to investors who suffered loss as a result of a breach.

264. The following rules and guidance were those principally referred to during argument.

Purpose

> 12.1.2G This chapter gives guidance to a firm, which is considering appointing an appointed representative, on how the provisions of section 39 of the Act … work. For example, it gives guidance on the conditions that must be satisfied for a person to be appointed as an appointed representative. It also gives guidance to a firm on the implications, for the firm itself, of appointing an appointed representative.
>
> 12.1.3G The chapter also set out the FSA's rules, and guidance on those rules, that apply to a firm before it appoints, when it appoints and when it has appointed an appointed representative. The main purpose of these rules is to place responsibility on a firm for seeking to ensure that:

(1) its appointed representatives are fit and proper to deal with clients in its name; and

(2) clients dealing with its appointed representatives are afforded the same level of protection as if they had dealt with the firm itself.

Appointment of an appointed representative (other than an introducer appointed representative

12.4.2R Before a firm appoints as an appointed representative (other than an introducer appointed representative) and on a continuing basis, it must establish on reasonable grounds that

…

(2) the person

(a) is solvent;

(b) is otherwise suitable to act for the firm in that capacity

…

(3) the firm [i.e. the appointing firm] has adequate

(a) controls over the person's regulated activities for which the firm has responsibility; and

(b) resources to monitor and enforce compliance by the person with the relevant requirements applying to the regulated activities for which the firm is responsible and with which the person is required to comply under its contract with the firm.

(4) the firm is ready and organised to comply with the other applicable requirements contained or referred to in this chapter

Suitability etc. of appointed representatives

12.6.1R If at any time a firm has reasonable grounds to believe that the conditions in SUP 12.4.2R, SUP 12.4.6R or SUP 12.4.8AR (as applicable) are not satisfied, or are likely not to be satisfied in relation to any of its appointed representatives, the firm must

(1) take immediate steps to rectify the matter; or

(2) terminate its contract with the appointed representative

Appointed representatives not to hold client money

12.6.5R

(1) A firm must not permit an appointed representative to hold client money unless the firm is an insurance intermediary …

(2) The firm must take reasonable steps to ensure that if client money is received by the appointed representative, it is paid into a client bank account of the firm or forwarded to the firm …

Regulated activities and investment services outside the scope of appointment

12.6.5R A firm must take reasonable steps to ensure that each of its appointed representatives

(1) does not carry on regulated activities in breach of the general prohibition in section 19 of the Act and

(2) carries on the regulated activities for which the firm has accepted responsibility in a way which is, and is held out as being, clearly distinct from the appointed representative's other business.

Senior management responsibility for appointed representatives

12.6.7 The senior management of a firm should be aware that the activities of appointed representatives are an integral part of the business that they manage. The responsibility for the control and monitoring of the activities of appointed representatives rests with the senior management of the firm.

Obligations of firms under the training and competence rules

12.6.11G A firm should take reasonable care to ensure that …
(2) its appointed representative has adequate arrangements in respect of training and competence, which meet the requirements in T/C

Compliance by an appointed representative with the contract

12.6.11AR A firm must take reasonable steps to establish and maintain effective systems and controls for ensuring that each of its appointed representatives complies with those terms of its contract which are imposed under the requirements contained or referred to in SUP 12.5.

The Claimants' submissions

265. Relying upon *Bilta (UK) Ltd v Nazir* [2015] UKSC 23, and its endorsement of the judgment of Lord Hoffmann in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, the Claimants contended that the rules of attribution needed to reflect the context and purpose of the rule for which they are required. Those cases also showed that the question of attribution does not depend upon the seniority or otherwise of the individuals involved, but upon the function that they are discharging.

266. The relevant rule in the present case is the statutory set of rules contained in SUP 12, to be viewed in the context of FSMA s.138D which gives a cause of action to a private person who suffers loss as a result of the contravention.

267. Particular reliance was placed upon SUP 12.4.2R., and in particular 12.4.2R (3). The Claimants argued that there was a continuing obligation upon Sense to establish upon reasonable grounds that Sense had adequate "resources to monitor and enhance compliance by the person with the relevant requirements applying to the regulated activities" for which Sense was responsible and with which MFSS was required to comply under the contract with Sense. Mr. Ingram was a key part of the resources which were used to monitor and compliance, and therefore it was appropriate that his knowledge should be attributed to Sense for the purpose of deciding whether or not Sense had fulfilled its supervisory duties properly.

268. The Claimants submitted that Mr. Ingram was an integral part of the compliance operation, and that his knowledge – like the other members of the supervision and compliance team (Mr. Netting, Mr. Owen and threesixty) – must be attributed to Sense. Mr. Ingram was an essential component of T&C, which sits at the heart of the compliance function. He was the only member of the compliance team to have a near daily presence at MFSS. For most practical purposes he was the only field-based supervisor and he carried out the preponderant part of the face-to-face supervision of Midas. If Sense had not used him to undertake the myriad tasks, then it would either have had to do them itself or Sense would have failed to commit sufficient resources in breach of SUP 12.4.2. If the function had been carried out by a Sense in-house T&C supervisor, then it would be unarguable to suggest that the supervisor's knowledge should not be attributed to Sense. As it is, Sense decided to use Mr. Ingram as a "member supervisor": he was therefore part of the resources committed to the supervision of MFSS. When discharging the T&C Supervisor function, Mr. Ingram was no different to Mr. Netting, Mr. Painter or Mr. Owen when (for example when Mr. Owen took over from Mr. Ingram in 2012) they undertook that role.

269. The Claimants also relied in that context, and generally, upon the Guidance in SUP 12.1.3G (2). This showed that there should not be a "two tier" system for directly regulated advisers and indirectly regulated advisers. Thus, the knowledge of the person carrying out the T&C supervision should be attributed to Sense whether or not that person was employed by Sense itself or by its AR.

270. Whilst maintaining that the seniority of Mr. Ingram was not the key question for attribution purposes, the Claimants contended that Mr. Ingram's role was not a "lowly" one. He was the person occupying the only day-to-day role in terms of face-to-face supervision of an indirectly regulated firm. If Mr. Ingram had been taken away, Sense

would have been in breach of its duty to allocate resources to monitor what was happening at MFSS.

271. The Claimants also relied heavily upon the document describing and setting out the "T&C Supervisor Job Role". They contended that even without taking into account the development of the law in *Meridian* and then *Bilta,* the nature of Mr. Ingram's role as set out in that document would result in attribution of his knowledge to Sense, applying ordinary agency principles. In that context, they relied upon the third category identified by Hoffmann LJ in *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, 703; viz, where the agent has actual or ostensible authority to receive communications.

272. The Claimants contended that if his knowledge is to be attributed, then Sense must necessarily have been in breach of its supervisory duty; since Sense did nothing about the scheme.

Sense's submissions

273. Sense contended that it was only if Sense had really left everything to Mr. Ingram, in terms of entrusting all its responsibility for supervision of MFSS to him, that Sense would be fixed with his knowledge. The general principle was that whether the knowledge of agent A is to be imputed to the principal P depends upon what P has employed A to do. Knowledge could only be imputed if it came to the agent within the scope of and for the purposes of his actual duties. Sense referred to Lord Halsbury LC in *Blackburn Low & Co v Vigors* (1887) 12 App Cas 531, 537-8 as authority for the proposition that the attribution of knowledge to the principal depends upon the specific authority which the agent has received. It is only when the employment of the agent is such that

> "that in respect of the particular matter in question he really does represent the principal, the formula that the knowledge of the agent is his knowledge is I think correct, but it is obvious that the formula can only be applied where the words "agent" and "principal" are limited in their application. To lay down as an abstract proposition of law that every agent, no matter how limited the scope of his agency, would bind a principal even by his acts is obviously and on the face of it absurd…"

274. It was therefore vital to recognise the very limited role played by Mr. Ingram. The evidence showed that he was a very small cog in D's supervisory machine. He conducted the T&C role which was essentially supportive rather than investigatory. He had no powers to take any important decisions or make any assessments. He was not employed as some kind of "mole" within MFSS on behalf of Sense. Indeed, although he carried out the particular tasks disclosed by the evidence, it is only by a loose use of language (as deprecated by Lord Halsbury in the above passages) that he may be described as an agent at all. It was of course, the case that he was an employee of MFSS at all material times.

275. Sense submitted that Mr. Ingram occupied a relatively junior role, relying on the evidence of their expert (Mr. Percival) that "the T&C role is fairly junior". It was not part of Mr. Ingram's role that he should identify wrongful or unauthorised transactions. Rather, it was Sense (or threesixty on its behalf) which was carrying out the file reviews,

and this was the way in which unauthorised transactions were investigated. The evaluation and assessment of the facts, in particular the question of whether or not the file reviews showed proper compliance by the advisers, was a matter for Sense, as was the ultimate decision as to whether an adviser should be rated red, amber or green. All of that showed that Mr. Ingram's role was very narrow. It was a means to assist and improve advisers, and was not part of the oversight and detection of wrongful conduct, whether that conduct be careless or deliberately wrong. Therefore Mr. Ingram did not have any sufficiently central or important role in the discharge of supervisory functions to make it just or appropriate that his knowledge be attributed to Sense.

276. At one point in its submissions, Sense accepted that there were some matters that could be attributed to Sense through Mr. Ingram, but there was only a very narrow scope for attribution. The only example given by Mr. Howarth where attribution might be possible was if Mr. Ingram had wrongly told Sense that a particular adviser had carried out his CPD in a particular area in circumstances where he had not done so, and the lack of CPD then led to negligent advice and a claim against Sense.

277. At the heart of Sense's submission was the need to look very closely at what the agent was there to do. If he has a role confined to a number of matters, and he obtains knowledge which was not "part and parcel" of those matters, then the knowledge was not to be attributed. Mr. Ingram only had a supportive role, and this was essentially responsive to what Sense asked him to do.

278. Sense also submitted that Mr. Ingram did not fit within any of the three categories of case which were identified by Hoffmann LJ in *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, 702-703. Mr. Howarth also relied upon the passage at 703h-j where Hoffmann LJ said that information received by an agent otherwise than as an agent cannot be imputed to the principal "simply on the ground that the agent owed to his principal a duty to disclose it".

279. Sense submitted that there was nothing in the statutory context which required Mr. Ingram's knowledge to be attributed to Sense. The case was unlike *Meridian*, where the purpose of the statute would be defeated if there had not been attribution. In the present case, the aims and the policy of FSMA 2000 and the rules made thereunder (in particular SUP 12) would not be defeated, since Sense itself had a duty to do things properly, and there was therefore no need to concentrate on the knowledge and role of Mr. Ingram.

280. In relation to SUP 12.4.2R, upon which the Claimants had heavily relied, Sense submitted that this was of no assistance, since Mr. Ingram's role was not properly described as the monitoring or enforcement of compliance. It was the delivery of T&C. Sense also emphasised that this rule did not impose an absolute obligation, but was qualified by "reasonable grounds"

281. Sense also drew attention to SUP 12.6.7G and SUP 12.6.11G. Sense submitted that SUP 12.6.7G showed that the responsibility lay with the senior management of the firm, and therefore the knowledge of individuals such as Mr. Netting or Mr. Owen would be attributable; but not the knowledge of everyone who had some obligation in relation to compliance. SUP 12.6.11G showed that the obligation was one of reasonable care only, and that it was permissible (consistent with the expert evidence) for delivery of T&C to be carried out by the AR itself, subject to proper oversight by the principal.

Analysis and conclusions

282. The most recent authoritative statement of the principles to be applied in relation to attribution is the judgment of the Supreme Court in *Bilta (UK) Ltd v Nazir* [2015] UKSC 23. The judgment of Lords Hodge and Toulson (with whom Lords Neuberger, Clarke and Carnwath agreed) endorses the well-known analysis of Lord Hoffmann in *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500. The relevant principles were summarised as follows:

> [187] A company can incur direct liability in at least three circumstances. First, the provisions of company legislation, a company's constitution (its articles of association, including provisions of a company's memorandum of association now deemed to be provisions of its articles by section 28 of the Companies Act 2006 ("the 2006 Act")) and the non-statutory rules of company law provide that certain acts of its board of directors are treated as the acts of the company…
>
> [188] Secondly, a company can also incur direct liability through the transactions of agents within the scope of their agency (actual or apparent). Thus, when an agent commits his or her company to a contract, the company incurs direct liabilities (and acquires rights) as a party to the contract under ordinary principles of the law of agency.
>
> [189] Thirdly, a statute or subordinate legislation or a regulatory body's code or rules of the common law or equity may impose liabilities or confer rights on a company. For example, a company as a legal entity is owed by its directors the general duties set out in sections 171 to 176 of the Companies Act even when the controlling director is also the sole shareholder.
>
> [190] In *Meridian Global Funds Management Asia Ltd v Securities Commission [1995] 2 AC 500*, Lord Hoffmann (at p 506) pointed out that it is a necessary part of corporate personality that there should be rules by which acts are attributed to the company. First, he identified the "primary rules of attribution" from company law, which is the first of the direct forms of liability which we describe above. He then referred to the general principles of agency and vicarious liability which in most circumstances determine a company's rights and obligations (p 507B). He recognised that there was a third category where, exceptionally, a rule of law expressly or impliedly excludes attribution on the basis of those general principles. For this third category, which is relevant to the third form of direct liability (above), he stated: "the court must fashion a special rule of attribution for the particular substantive rule". He described the fashioning of that special rule of attribution in these terms (p 507E-F):

> "This is always a matter of interpretation: given that it is intended to apply to a company, how is it intended to apply? Whose act (or knowledge or state of mind) was *for this purpose* intended to count as the act etc. of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy."

[191] The relevance of the context in which the question is asked – "Is X's conduct or state of mind to be treated as the conduct or state of mind of the company for the purpose in hand?" – is not limited to Lord Hoffmann's third category. The legal context, ie the nature and subject matter of the relevant rule and duty, is always relevant to that question. In *Bowstead & Reynolds on Agency* (20th ed 2014) Professor Peter Watts and Professor Francis Reynolds stated (at para 8-213):

> "Before imputation occurs there needs to be some purpose for deeming the principal to know what the agent knows."

In the 19th ed the learned editors made the same point in the same paragraph thus:

> "The rules of imputation do not exist in a state of nature, such that some reason must be found to disapply them. Whether knowledge is imputed in law turns on the question to be addressed."

We agree; an analysis of the relevant case law supports that view in relation to each category of rules of attribution.

283. At paragraph [204] – [205], Lords Hodge and Toulson considered the question of attribution in the context of a claim by a third party against a company "arising from the misconduct of a director, employee or agent":

In the first case, where a third party makes a claim against the company, the rules of agency will normally suffice to attribute to the company not only the act of the director or employee but also his or her state of mind, where relevant. In this context, the company is like the absent human owner of a business who leaves it to his managers to run the business, while he spends his days on the grouse moors (to borrow Staughton LJ's colourful metaphor in *PCW Syndicates v PCW Reinsurers [1996] 1 WLR 1136*, 1142). Where the rules of agency do not achieve that result, but the terms of a statute or contract are construed as imposing a direct liability which requires such attribution, the court can invoke the concept of the directing mind and will as a special rule of attribution. Thus where the company incurs direct liability as a result of a wrongful act or omission of another (as in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* and *McNicholas Construction Co Ltd v Customs and Excise Comrs*)

> it is deemed a wrongdoer because of those acts or omissions. If it is only vicariously liable for its employee's tort, it is responsible for the act of the other without itself being deemed a wrongdoer and without the employee's state of mind being attributed to it.

284. Accordingly, in the light of this most recent authority, there is an initial question is whether the ordinary rules of agency suffice to attribute to Sense the knowledge of Mr. Ingram. However, I consider that the Claimants were correct to submit that the present case falls within what Lords Toulson and Hodge described as the "third category" (see *Bilta* paragraph [189]), because one is concerned here with the imposition of liabilities by a regulatory body in a statutory context. The fashioning of a rule of attribution must in that context depend upon applying the approach in *Meridian* quoted in paragraph [190] of *Bilta*: i.e. applying the usual canons of interpretation, taking into account the language of the rule and its content and policy. Indeed, in my judgment, even if one were to start by trying to apply an agency analysis, it would in any event be necessary to ask the question identified in paragraph [191] of *Bilta*, viz: "Is Xs conduct or state of mind to be treated as the conduct or state of mind of the company for the purpose at hand". This leads back to the language of the rule and its content and policy.

285. I was therefore not persuaded that an ordinary agency analysis, even if Mr. Ingram were to be regarded as an "agent" of Sense, was of any relevance to the issue that required resolution. This is not a case where a claim was being made in relation to what Lords Toulson and Lords Hodge describe in paragraph [188] as a transaction of an agent. The present argument does not concern, for example, a contract made by Mr. Ingram, or monies received by him, or a tort committed by him. The issue is whether Sense was in breach of its supervisory duties under SUP, and in that context whether Mr. Ingram's knowledge can be attributed to them.

286. The Claimants sought to apply (albeit very much as an alternative) an ordinary agency analysis by submitting that the claim fell within the third category in *El Ajou*. I was not persuaded by this argument. The present is not a case which concerns notifications equivalent to notices to quit, or indeed any kind of notification. As *Bowstead and Reynolds* explain in Article 94, the relevant line of authority is concerned with the formal giving of information, and the agent's actual or apparent authority to receive it.

287. Before considering the critical question of whether Mr. Ingram's knowledge was intended to count as the knowledge of Sense for the purposes of SUP 12, I make some additional observations as to the role that Mr. Ingram played in the light of the arguments advanced by the parties.

288. First, it is important to recognise that Mr. Ingram was an employee of MFSS, not Sense, and also to view his role and work in the context of the contractual relationship existing between Sense and MFSS and the regulatory background. Under the ARA, MFSS undertook various obligations to act in a manner compliant with the regulatory system and Sense's procedures, to train their advisers, and to co-operate with Sense in order that Sense could seek to ensure that this was being done: see for example Clauses 3.5, 5.10 and 5.23.5 and other clauses set out in Section C above. The responsibility for acting in a compliant way was a responsibility upon MFSS generally: MFSS undertook under Clause 3.5 to act in a compliant way and to procure that its staff did so. Mr. Ingram's role at MFSS, as set out in the Job Role document, was in my view directed

towards ensuring that MFSS's obligations in these respects were being carried out, and demonstrating to Sense that they were being carried out. But it did not seem to me that, to use the language of Lord Halsbury in *Blackburn Low*, it could properly be said that Mr. Ingram "really does represent the principal" in respect of any particular matter; save perhaps in relation to being a conduit of communication of Sense's decisions, for example in relation to file reviews.

289. The fact that the Job Role document, defining Mr. Ingram's role, had been prepared by Sense – in fact it was or was based on a standard form template of threesixty – does not alter this conclusion. Sense had regulatory responsibilities, and it is not surprising that Sense would want to define clearly the responsibilities of the T&C Supervisor within the supervised firm. Indeed, SUP 12.6.11G provided that a firm [Sense] should take reasonable care to ensure that the AR had "adequate arrangements in respect of training and competence, which meet the requirements of T/C". Ensuring that a T&C Supervisor had been appointed by the AR went towards the fulfilment of that obligation.

290. Secondly, as I have already said, Mr. Ingram occupied a role within Sense's "overall compliance architecture". But this is a very general expression, and it seeks to blur the distinction between those who worked for Sense, and Mr. Ingram who worked for MFSS, and I do not consider that it materially assists in relation to the question of attribution.

291. Thirdly, as to the debate between the parties as to whether Mr. Ingram's role was "very limited" or narrow, I agree with the Claimants that this is not an appropriate description: the Job Role document shows that Mr. Ingram had a broad range of responsibilities. There was also a debate as to whether or not Mr. Ingram's job could be described as "fairly junior" or the like. Mr. Morrey (the Claimants' expert) disagreed with this description. Mr. Morrey said, correctly in my view, that whilst Mr. Ingram carried out some clerical tasks, for example getting approval from Sense for MFSS brochures and other documentation, he also had a role as nominated supervisor for all the advisers which put him in a position of significant responsibility. (I note that the role of getting approval for brochures and the like was a role carried out for MFSS rather than Sense). He therefore had a mix of responsibilities which did not lend itself easily to a label such as "fairly junior", although he clearly was not part of the senior management of MFSS and (as shown by the fact that one of his other tasks was acting as a paraplanner) his status was somewhat below that of the advisers at MFSS.

292. Fourthly, I agree that Mr. Ingram was not employed as a "mole" for Sense within MFSS. He was an MFSS employee and (as discussed later in this judgment – see Section L) the expert evidence showed it is not unusual for a principal such as Sense to give the T&C role to an employee within the AR. Indeed, it seemed to me that this was a sensible arrangement, since the employee of the AR would be present on the ground at the ARs premises and would have day-to-day contact with the advisers.

293. Fifth, given the nature of his responsibilities, I consider that it was part and parcel of Mr. Ingram's role to recognise, if he saw it, any failure to comply with compliance standards which he could observe on the ground at MFSS and to report them to Sense. Indeed, MFSS had such an obligation under Clause 3.6 of the ARA. Mr. Ingram did not, however, make any report to Sense about the scheme until August 2014, and MFSS were clearly in breach of Clause 3.6.

294. In that connection, the Claimants relied upon Sense's evidence that Mr. Ingram was its "eyes and ears" and "man on the ground". These phrases clearly lack legal precision and do not in my view materially assist on the question of attribution. They do, however, reinforce the conclusion that the recognition and reporting of compliance problems, should Mr. Ingram become aware of them through his day-to-day work at MFSS, was part of his role. That conclusion is also reinforced by the fact that part of Mr. Ingram's job was to "coach" and assist the advisers so as to ensure that they met compliance standards. If, therefore, it came to Mr. Ingram's attention that they were not doing so, it was his responsibility to point this out to them so that they could improve their performance in the future. For this purpose I do not consider that it makes any difference whether the deficiencies in compliance came to Mr. Ingram's attention via the results of Sense's file reviews or because of what Mr. Ingram himself observed on the ground. Indeed, it would make something of a nonsense of the T&C regime, and turn it into a tick-box exercise, if Mr. Ingram were to proceed to carry out matters such as coaching, discussion in 1-1 meetings and organising attendance at CPD events, whilst leaving uncorrected and unreported significant breaches of compliance of which Mr. Ingram became aware through his own observations.

295. Against this background, I turn to consider the language of the relevant rules, its content and policy. There are a number of features which I consider to be important.

296. First, I agree with Sense that SUP 12 (as illustrated by SUP 12.6.7G and SUP 12.6.11G) "throws the spotlight" (as Mr. Howarth described it) onto Sense, rather than the AR, to do certain things, and to do them properly. They are a set of rules regulating how Sense conducts its own business, albeit in the context of having accepted responsibility for certain business to be carried on by another party (the AR). But the rules clearly distinguish between the principal "firm" and the AR which is being supervised.

297. This is illustrated by SUP 12.4.2R which places the responsibility on the "firm" to establish certain matters before it appoints the AR. This aspect of the rule is necessarily looking at the management of the principal firm, since it is concerned with what happens prior to appointment. It follows that one is also looking at the management of the principal firm when considering whether the continuing obligation ("and on a continuing basis") is satisfied.

298. One of those matters (SUP 12.4.2R (3)) is that the firm should establish on reasonable grounds that it has adequate "controls over the persons' regulated activities for which the firm has responsibility". Again, this draws the distinction between the firm, which puts the controls in place, and the persons (i.e. the AR) who are subject to the controls. The ordinary construction of this rule, in my view, is that if proper controls have been put in place by the firm itself, then there would be no breach of this rule. That conclusion should apply even if it turned out that (to the knowledge of an individual with the AR firm itself) the controls were being circumvented.

299. Similarly, it is the principal firm which must, in certain circumstances, terminate the relationship with the AR if the firm has reasonable grounds to believe that the conditions in (e.g.) SUP 12.4.2R are not satisfied. The decision-making in that respect must be that of the management of the principal firm, rather than that of individuals within the AR firm. The question of whether the firm had "reasonable grounds to believe", and hence whether there was a breach of its regulatory responsibility to

terminate the relationship, must equally depend upon what the management of the firm, rather than individuals within the AR, know.

300. The same approach and distinction is apparent in SUP 12.6.6R. This provides that it is for Sense to "take reasonable steps" in relation to the conduct of each its appointed representatives: i.e. reasonable steps to ensure that the AR does not carry on regulated activities in breach of section 19.

301. Taken as a whole, these rules are clearly directed at the firm, which must mean those who form part of the management of Sense (the principal), rather than the employees or management of the AR. It would therefore be somewhat surprising if there were to be a breach of these rules by the principal in circumstances simply because of the knowledge of an individual within the AR firm itself, and notwithstanding the exercise of reasonable care by the management of the principal firm itself.

302. Secondly, it is important to note that, as Sense submitted, the rules do not generally impose absolute obligations on Sense, but instead are concerned with the exercise of reasonable care. For example, SUP 12.4.2.R, which was the principal rule on which the Claimants relied, requires Sense to establish certain matters "on reasonable grounds'. Similarly, SUP 12.6.6R requires Sense to "take reasonable steps" to ensure. On occasion, the rules do impose what might be regarded as an absolute obligation: for example SUP 12.6.5R provides that a firm "must not permit" an appointed representative to hold client money. (It was not suggested that, in the present case, Sense contravened this rule, because the holding of client money was clearly prohibited by Sense). But the relevant rules relied upon in the present context impose a standard of reasonableness. In context, this must mean the reasonableness of the conduct of those who are managing the principal firm. Again, therefore, it would be surprising if there were to be a breach of the rules if the managers of the principal firm exercised reasonable care, but one of the individuals employed by the AR firm did not.

303. Thirdly, one consequence of a breach of the rules, as the Claimants pointed out, is that the firm is exposed to fines or public censure. There is therefore a quasi-criminal element attached to breach. To my mind, this consequence militates against holding the firm responsible for the conduct of individuals within the AR who form no part of the management of the principal firm.

304. Fourthly, I consider that it is of some significance that SUP 12.4.7G, albeit guidance rather than a rule, says that the responsibility for control and monitoring "rests with the senior management of the firm". I accept, as the Claimants submitted, that this is guidance rather than a rule. However, it seems to me to be a further indication that it is the knowledge and conduct of the management of the principal firm – rather than an individual within the supervised firm – that should be relevant for the purposes of deciding whether or not the requirements of SUP 12 have been breached.

305. Fifth, I also attach some significance to SUP 12.6.11G, albeit again guidance rather than a rule, which concerns training and competence rules, and to which I have already referred. This indicates that it is the appointed representative which must put in place "adequate arrangements in respect of training and competence, which meet the requirements in TC", whereas it is the responsibility of the principal to "take reasonable care to ensure" that the appointed representative has put these arrangements in place. The distinction between the supervising "firm" and the AR in that context, and the fact

that the firm's responsibility is again an obligation of "reasonable care to ensure", suggests that the knowledge of the individual within the AR firm responsible for training and competence is not the relevant knowledge for the purposes of deciding whether or not the firm has breached its supervisory duties.

306. Against this background, I do not consider that it is appropriate or necessary to fashion a rule of attribution which has the effect of rendering Sense in breach of the rules in SUP 12 as a consequence not of the conduct of Sense's management, but because of the knowledge of an individual employee within the supervised firm. The position would be different if this were a case where there had been (as the Claimants suggested in opening) a wholesale delegation of compliance responsibilities to Mr. Ingram. But this was clearly not the case on the facts. Sense's own management, through the process of file reviews and other matters described above, took a hands-on approach to the discharge of their responsibilities under SUP 12. Mr. Ingram's work on the ground, as MFSS's T&C Supervisor, was largely reactive to the compliance work carried out by Sense itself, via file reviews and analysis of materials sent to Sense.

307. It also seems to me to be important, as Sense submitted, that the SUP rules contemplate that the principal firm will fulfil its responsibilities if it exercises reasonable care. The effect of attributing Mr. Ingram's knowledge, in circumstances where there has been no wholesale delegation to him, would be to negate the firm's defence that it has exercised reasonable care. Although great care needs to be exercised in transferring the reasoning of the courts in one statutory context to another, it seems to me that *Tesco Supermarkets v Nattrass* [1972] AC 153 (and discussed at paragraph [192] of *Bilta*) shows that this is a very important consideration. The consequence of the Claimants' argument in the present case is that Sense would (by virtue of the attribution of Mr. Ingram's knowledge) be held to be automatically in breach of their supervisory duties (and exposed to fines and public censure) as a result of matters which were unknown to any of their senior or other management, and with no practical way of arguing that reasonable care was exercised.

308. This point can be tested by consideration of the terms of SUP 12.4.2R, on which the Claimants' case was principally based. If the principal firm carries out proper checks into the matters covered by that rule before appointing the AR, and monitors these matters properly "on a continuing basis", then it would appear that no criticisms could be made; because the firm could rightly say that it had established the relevant matters "on reasonable grounds". However, the effect of the attribution rule for which the Claimants contend is to put the firm automatically into breach simply because of the knowledge of one of the individuals at the AR firm involved in operational compliance. Even if that individual could loosely be described as part of the "resources to monitor and enforce compliance", it seems to me that there would be no breach of SUP 12.4.2 provided that the firm could demonstrate that it had established "on reasonable grounds" that the resources that it had put in place were adequate. If the resources put in place were adequate, and were established on reasonable grounds to be adequate, it is a non-sequitur to say that there was a breach by the principal firm simply because one of those "resources" happened to know something with the principal firm did not.

309. However, I was in any event unpersuaded that (applying the wording of 12.4.2R) it was appropriate to regard Mr. Ingram as one of the resources of "the firm" (Sense) for monitoring and enforcing compliance by MFSS. It seems to me that the human resources which "the firm" (i.e. Sense) deployed for monitoring and enforcing

compliance were Mr. Netting, Mr. Painter and Mr. Owen. Mr. Ingram was, as I have said, an employee of the supervised firm, which had its own compliance obligations, which Mr. Ingram's work was designed to assist in fulfilling.

310. Furthermore, I consider that Sense was correct to submit that that there is nothing in the statutory context which requires Mr. Ingram's knowledge to be attributed to Sense, and that the purpose of the statute (here the relevant SUP rules) would not be defeated if Mr. Ingram's knowledge was not attributed. Lords Hodge and Toulson in *Bilta* (see paragraph [195]) approved the question posed by Dyson J. in *McNicholas Construction Co Ltd. v Customs and Excise Comrs* [2000] STC 553:

> "The question in each case is whether attribution is required to promote the policy of the substantive rule, or (to put it negatively) whether, if attribution is denied, that policy is frustrated."

Similarly, in *Meridian*, Lord Hoffmann referred to "defeating" the policy of the relevant statute. In *Morris v Bank of India* [2005] 2 BCLC 328 at [108], the Court of Appeal referred to "severely emasculating" the policy of the relevant Act.

311. It did not seem to me that the non-attribution of the knowledge of a person in Mr. Ingram's position would frustrate or defeat or severely emasculate the policy of SUP 12. SUP 12 can work reasonably and satisfactorily by considering whether there were any supervisory failures on the part of Sense's management, bearing in mind the knowledge that they had. Indeed, the Claimants advanced a case in numerous respects in that regard, and I deal with their arguments, including the expert evidence, in Sections L and M below. I considered that the case advanced in those respects, for example insufficient monitoring and failure to react properly to information relating to the management of the AR, was precisely the type of case which (if established) would naturally be regarded as a breach of the supervisory obligations. They raised squarely the question of whether Sense had put in place adequate controls over the regulated activities of MFSS (see SUP 12.4.2R (3) (a))) and whether reasonable steps were taken to ensure that MFSS did not carry on regulated activities in breach of the s.19 prohibition (see SUP 12.6.5R (1)). By contrast, if that case is not well-founded, because Sense took reasonable steps, it would be a strange result to say that it was nevertheless in breach of its supervisory obligations because of the knowledge of an employee of MFSS, simply because that employee was involved in certain operational aspects of compliance.

312. For these reasons, I do not consider it appropriate to attribute Mr. Ingram's knowledge to Sense, and thereby hold that Sense were automatically in breach of their supervisory responsibilities.

313. In reaching this conclusion, I acknowledge that SUP 12.1.3G (on which the Claimants heavily relied) does identify the "main purpose" of the rules as being to "place responsibility on a firm for seeking to ensure that … clients dealing with its appointed representatives are afforded the same level of protection as if they had dealt with the firm itself". This is guidance rather than a rule. Again the language is not absolute: the guidance indicates that the rules are "seeking" to ensure that clients have the same level of protection. It is no doubt true the case that if Mr. Netting or Mr. Owen had knowledge of the scheme, and did nothing about it, there would have been a breach of Sense's

supervisory duties, and investors would have a remedy against Sense. But I not consider that SUP 12.1.3G means that the knowledge of Mr. Ingram, or indeed others at MFSS, should be attributed to Sense so as to ensure that the same remedy exists as it would in the situation where Mr. Netting had known about the scheme. The premise of SUP 12.1.3G is that if the rules are followed, investors will be protected in the same way as if they were dealing directly with the firm. No doubt that will usually be the case, since the exercise of reasonable care will bring about the appropriate protection for investors. But there may be cases – for example where there is a well-disguised fraud at the AR– where the reasonable steps required by the rules are not sufficient to protect an investor from loss. But I do not think that it follows from SUP 12.1.3G that, in the light of this possibility, it is necessary or appropriate – bearing in mind in the language of the other rules and guidance to which I have referred – to fashion a rule of attribution that has the result that the knowledge of an individual within the AR firm, and who formed no part of the senior management (or even the management) of the principal firm, should be attributed to the principal firm.

K: Vicarious Liability

The Claimants' submissions

314. The Claimants contended that principles of vicarious liability would render Sense liable for breaches by MFSS's advisers of their common law duty of care, for example by giving poor advice in relation to the scheme or misstating that the product was safe and regulated. The underlying tort was the negligent advice or mis-selling by an adviser, and Sense would be liable for it applying the principles in the recent authorities. At the very least, Sense would be vicariously liable for the acts or omissions of Mr. Ingram, who was under its control and direction.

315. The Claimants submitted that the modern law of vicarious liability no longer draws a line between employees and independent contractors. *Cox v Ministry of Justice* [2016] UKSC 10, [2016] AC 660 established that the essential factors in a relationship giving rise to vicarious liability for the acts and omissions of another – even in the absence of contract of employment - are that: (a) the tort had been committed as a result of activity being undertaken by the tortfeasor on behalf of the defendant; (b) that activity was integral to the defendant's business activities; and (c) the defendant by employing the tortfeasor to carry out the activity had created the risk of the tort being committed by the tortfeasor.

316. In his oral submissions, Mr. McMeel submitted that this is not a case (see *Cox* para [29]) where the tortfeasor's activities are entirely attributable to a recognisably independent business, namely the business of MFSS. Reliance was placed on Mr. Ingram's agency role as training and competence supervisor, and the fact that he was supervised and to that extent controlled. More generally, the MFSS advisers who were dealing with clients were integral to Sense's business. Sense only made money because advisers meet people face to face and sell them products. That was the business which Sense had equipped the advisers to go out and do, that they train them to do, and which they supervise. Sense thus sought to exercise control over the advisers, through both I/O and its T&C programme. Sense had created the risk that individual claimants might be affected by misconduct in their role. So there was vicarious liability for all the activities of the MFSS advisers. The firms in the Sense network were not entirely independent businesses. They were interdependent and interconnected. Sense had no

business without the network firms that belonged to it, and those network firms could not carry out legitimate business without Sense.

317. In the alternative if the modern test articulated by the Supreme Court in *Cox* is not applicable to cases of agency (see para [15] of the judgment in *Cox*) or to reliance-based torts such as negligent mis-statement, nevertheless the Claimants met what they described as the traditional two-stage test (modified for the non-employment context) of the tort of negligent misstatement being committed by Midas's advisers (a) in the course of their agency for Sense, and (b) within the scope of the apparent authority conferred upon by Sense: see *Armagas Ltd v Mundogas SA* [1986] AC 717, 738-39.

Sense's submissions

318. Sense drew attention to the Claimants' pleaded case on vicarious liability in paragraph 28M of the Amended Points of Claim in a section headed "Attribution of Knowledge of Mr. Ingram". Sense submitted that the only pleaded case of vicarious liability concerned Mr. Ingram. This meant that the issue was very narrow, since the only claimant who was introduced by Mr. Ingram (and to whom Mr. Ingram could arguably have acted tortiously in breach of his duty of care) was Mr. Masson. However, they also submitted that the Claimants' argument on vicarious liability was ill-founded whether based on Mr. Ingram or otherwise.

319. Sense submitted that the principles in *Cox* were not applicable in the present case, which is concerned with agency. The recent decision in *Frederick v Positive Solutions* [2018] EWCA Civ 431, in particular paragraphs [67] and [77], meant that the test to be applied for reliance-based torts was whether or not the agent had acted within the scope of his actual or apparent authority.

320. Even if the *Cox* principles were to be applied, however, there would be no vicarious liability. All the advisers (including Mr. Ingram in that capacity) were an integral part of MFSS, not Sense. None of them had become part of Sense's business so as to render them individuals for whose acts and omissions Sense would be vicariously liable. Even Mr. Ingram carried out a number of other tasks other than the role of T&C Supervisor. Sense repeated their submission that, even as T&C supervisor Mr. Ingram had a limited role, and was an employee of MFSS not Sense. He was acting as an integral part of the business of MFSS, not Sense.

321. A separate point, on which Sense relied heavily, concerned the fact that the scheme was Mr. Greig's scheme, not an MFSS scheme. They relied upon various features of the evidence, in particular:

i) All those at MFSS who sold the scheme, or who were aware of it, regarded it as entirely separate from the proper business conducted by MFSS as agent for Sense. It was a scheme run by Mr. Greig, not MFSS.

ii) Thus, there was no semblance of a proper advice process. There was no fact find and no discussion of suitability. None of the suite of documents which would be generated by a proper advice process, which was undertaken in the course of MFSS's activities as agent, came into existence.

iii) No documents in connection with the scheme were uploaded to I/O, despite the fact that all advisers were aware of the importance attached to uploading of documents.

iv) There was an understanding among advisers and administrative staff that the scheme was not to be revealed to Sense, as demonstrated by the fact that no documents were uploaded to I/O even though the scheme ran for 7 years during the time when MFSS was an AR of Sense.

v) The documents relating to the scheme were kept in a single "scheme file"; i.e. a file that contained documents relating to all clients in the scheme.

vi) The monies deposited were not paid into MFSS's account, but instead into the Midas Financial Aberdeen account. Payments to investors were made from that account, not from the MFSS account. Commissions on the deposits within the scheme were paid from that account as well, rather than from the MFSS account.

vii) The scheme had started operating in 2002, some 5 years before the AR Agreement between Sense and MFSS. MFSS itself was not incorporated until 2006, some 4 years after the scheme started.

322. For all those reasons, the scheme was clearly a matter which was outside the conduct of business under the ARA. It was business done by Mr. Greig on his own account and not business done by MFSS. It was an unauthorised scheme which Mr. Greig was running for his own benefit, and not putting into the system in any way shape or form.

Analysis and conclusions

323. I agree with Sense that the Claimants' wider case, which sought to establish vicarious liability for the torts of all the advisers, was not pleaded. Nevertheless, the Claimants' written opening for the trial (paragraph 3.101) did advance a case relating to all the advisers (and in the alternative just Mr. Ingram) and this gave rise to no objection at the time. It also seems to me that the facts, relied upon in relation to the wider case of vicarious liability, were thoroughly explored at the trial, and the issue on vicarious liability is an issue of law arising from those facts. In these circumstances, I consider that the Claimants ought to be permitted to advance their wider case and I therefore address its merits below.

324. I have previously concluded that the advice given in relation to the scheme fell outside the scope of the actual and apparent authority of MFSS. It is highly arguable that this means that there is no scope for vicarious liability given that the relevant tortious conduct relied upon by the claimants comprise reliance-based torts: see the discussion in *Bowstead and Reynolds on Agency*, Article 90 and in particular paragraph 8-180. However, this was the point left open by the Court of Appeal in *Frederick* (see paragraphs [67] and [77]), where the court proceeded on the assumption that the principles set out in *Cox* are to be applied. I too shall make this assumption in the Claimants' favour.

325. The relevant principle is summarised in paragraph [24] of *Cox*:

> The result of this approach is that a relationship other than one of employment is in principle capable of giving rise to vicarious liability where harm is wrongfully done by an individual who carries on activities as an integral part of the business activities carried on by a defendant and for its benefit (rather than his activities being entirely attributable to the conduct of a recognisably independent business of his own or of a third party), and where the commission of the wrongful act is a risk created by the defendant by assigning those activities to the individual in question.

326. Lord Reed expanded upon this concept at paragraphs [29] – [30]

> [29] It is important, however, to understand that the general approach which Lord Phillips PSC described is not confined to some special category of cases, such as the sexual abuse of children. It is intended to provide a basis for identifying the circumstances in which vicarious liability may in principle be imposed outside relationships of employment. By focusing upon the business activities carried on by the defendant and their attendant risks, it directs attention to the issues which are likely to be relevant in the context of modern workplaces, where workers may in reality be part of the workforce of an organisation without having a contract of employment with it, and also reflects prevailing ideas about the responsibility of businesses for the risks which are created by their activities. It results in an extension of the scope of vicarious liability beyond the responsibility of an employer for the acts and omissions of its employees in the course of their employment, but not to the extent of imposing such liability where a tortfeasor's activities are entirely attributable to the conduct of a recognisably independent business of his own or of a third party. An important consequence of that extension is to enable the law to maintain previous levels of protection for the victims of torts, notwithstanding changes in the legal relationships between enterprises and members of their workforces which may be motivated by factors which have nothing to do with the nature of the enterprises' activities or the attendant risks.

> [30] … The individual for whose conduct it may be vicariously liable must carry on activities assigned to him by the defendant as an integral part of its operation and for its benefit. The defendant must, by assigning those activities to him, have created a risk of his committing the tort.

327. I do not consider that the application of these principles to the facts of the present case produce the result that Sense is vicariously liable for any torts committed by the MFSS advisers (including Mr. Ingram) in the course of advising the claimants. Here, MFSS

was clearly carrying out a recognisably independent business of its own. It had its own premises in Aberdeen, its own directors, its own administrative staff, and various advisers that it decided to engage. It filed its own accounts, and (as the evidence in the case showed) its financial fortunes depended upon the efforts of its employees and in particular the success of its financial advisers. The clients of MFSS received documentation, such as Terms of Business and suitability letters, which were on MFSS paper. The evidence in the case showed that the claimants, correctly, considered themselves to be clients of MFSS, with many of them accepting that they had not heard of Sense. The fact that it was an independent business of its own is also illustrated by the fact that, after incorporation and prior to joining the Sense network, it was not part of any network but was directly authorised. It is also illustrated by events shortly after MFSS did join the Sense network, when Sense learned that MFSS had been approached by another network, and that Mr. Greig was thinking of transferring MFSS to that network. The existence of an "Appointed Representative" relationship between Sense and MFSS, and the fact that certain sums were payable to Sense by MFSS as part of their contractual agreement, does not mean that MFSS was not a recognisably independent business.

328. The test in *Cox* requires focus on the position of the individual tortfeasors (here the advisers) for whom it is alleged that there is vicarious liability: see [29]. Here (and assuming in the Claimants' favour that the scheme is to be regarded as an MFSS scheme rather than Mr. Greig's scheme), the advisers' activities were in my view entirely attributable to the recognisably independent business which was carried on by MFSS. Those advisers worked for MFSS and most if not all of them had joined at a time when MFSS was directly authorised. They worked from MFSS's premises in Scotland (although some of them may have worked primarily from home in Scotland), and were remunerated by MFSS. They did of course have some contact with Sense, for example when training events were organised by Sense, or when a Sense representative went to the Aberdeen office, and during the time when Mr. Owen was responsible for T&C. But this was by no means on a daily basis or even weekly basis, and they could not be regarded as part of the "workforce" of Sense.

329. Furthermore, as shown by paragraph [30] of *Cox,* it is necessary that the individual for whose conduct a defendant may be vicariously liable, must "carry on activities assigned to him by the defendant as an integral part of its operation and for its benefit". In the present case, there was no evidence which suggested that Sense assigned activities to the advisers in a manner which bears comparison with the cases, including the modern cases such as *Cox*, in which vicarious liability has been imposed. It is of course true that, in the highly regulated world of financial services, and in consequence of its potential liability under s.39 and the supervisory duties imposed under SUP 12, Sense needed to monitor the way in which the advisers were carrying out their advisory roles. Sense also had to take steps to ensure that they received appropriate training. But this seems to me to be a long way from a case where it can be said that activities were assigned. The advisers, who were engaged by MFSS rather than Sense, essentially worked as independent financial advisers, seeking to develop their own client base in order to sell financial products.

330. In considering the relationship between a principal and an AR firm in the context of vicarious liability, and in particular the fact that member firms are recognisably independent businesses, I found useful the evidence of Mr. Percival which I have

previously described at the start of this judgment: see Section C paragraph [23] above. A network is a way of facilitating the operation of a number of recognisably independent businesses. The advisers continue to work for the individual independent businesses, and do not (at least in the manner contemplated in the case-law on vicarious liability) become integrated into the business being carried on by the principal. The relationship is one of principal and agent, with each business being separate albeit united by the agency relationship which exists.

331. The second aspect of the test set out in *Cox* is that the commission of the wrongful act is a risk created by the defendant by assigning those activities to the individual in question. Here, as I have said, I do not consider that Sense assigned activities to the advisers. But in any event it would be a strange conclusion on the facts of the present case to say that Sense had created the risk of the wrongful act. After all, the relevant scheme had been operating for many years prior to September 2007, when MFSS became an AR of Sense. Indeed, it had been operating prior to and from the time when MFSS had been incorporated, and was directly authorised. It is therefore difficult to see how it can be said that Sense created the risk. Had MFSS not become part of the Sense network but remained independent, then the scheme would have continued.

332. I consider that the above reasons as to why there is no vicarious liability apply to the advisers generally, and that there is no reason to distinguish Mr. Ingram from the other advisers. He formally became an adviser in 2010 but had previously acted as a promoter of the scheme to some individuals, receiving commissions from Mr. Greig. In so far as Mr. Ingram was formally an adviser after 2010, he is no different from the other advisers. In so far as he acted informally as an adviser prior to 2010, in connection with his promotion of the scheme, there is again no reason to distinguish him from the other advisers.

333. Additionally, Mr. Ingram's advisory/promotional activity in relation to the scheme had nothing whatever to do with his role as T&C supervisor as set out in the Job Role document. Thus, there would be no vicarious liability flowing from his role as T&C supervisor because – applying the test in *Muhamud v Wm Morrison Supermarkets plc* [2016] UKSC 11 – there was no sufficient connection between that job and any wrongful conduct in advising investors to make it right, as a matter of social justice, for Sense to be held liable.

334. In the light of these conclusions, it is not necessary to address in detail Sense's other argument against vicarious liability based upon the proposition that the scheme was Mr. Greig's scheme, rather than an MFSS scheme. I was not persuaded by this argument. Had it been the only argument advanced, I would have rejected it for the following reasons.

335. It is true (as Sense submitted) that there was no proper advice process; that documents were not uploaded to I/O; that it was understood that Sense was not to be told about the scheme; that the monies were not paid into MFSS's bank account; and that the scheme had pre-dated the incorporation of MFSS and the relationship with Sense. I agree that it was an unauthorised scheme, which Mr. Greig was not putting into the system in any shape or form. But I do not think that these facts mean that the scheme was a recognisably independent business of Mr. Greig (as opposed to MFSS), particularly bearing in mind that the only documentation given to clients relating to the scheme (following the founding of MFSS), namely the confirmation letters, were written on

MFSS headed notepaper. Nor was there any suggestion, in the evidence of the Claimants relating to their conversations about the scheme, that they were told that the scheme was in any way distinct from the business of MFSS. Nor was I persuaded that, at the time, advisers and others at MFSS believed that the scheme was distinct from the business of MFSS, or that this was the reason why the scheme was not disclosed to Sense. To the extent that witnesses agreed with this proposition in the course of their cross-examination, I thought that this was something of an ex post facto rationalisation as to why the existence of the scheme had been kept from Sense. The reason why the scheme was not disclosed was that it was firmly understood at MFSS that it should not be disclosed, no doubt because disclosure would incur the wrath of Mr. Greig and would result in the scheme (which appeared to be generating good returns for clients and commissions for the advisers) being shut down.

L: Breach of Supervisory duties – failure to monitor and related arguments

L1: The expert witnesses

336. The Claimants contended that that Sense was in breach of its supervisory duties because it failed properly to monitor MFSS. It put in place inadequate controls and checks in relation to whether MFSS was carrying out unauthorised business. There was therefore a breach of SUP 12.6.5R which required Sense to "take reasonable steps to ensure that each of its appointed representatives … does not carry on regulated activities in breach of the general prohibition in section 19 of the Act."

337. In relation to these issues, the Claimants called Mr. David Morrey as their expert and Sense called Mr. Rory Percival. Mr. Morrey is a partner in the Financial Services Regulatory Advisory section of Grant Thornton LLP. He has 27 years experience in financial services: he originally qualified as an accountant with Ernst and Young, where he worked in their Financial Services Risk Consulting practice, and then undertook risk and compliance roles within industry. In his current position, he conducts, as an expert, Skilled Person Reviews for the Financial Conduct Authority. During the course of his career, he has never been a compliance officer for a network, although he had an equivalent role in asset management/ investment business. He has not worked for the regulator, but did work for 13 years for (what is now) the Aviva group in a variety of risk management and regulatory roles, culminating in appointment as deputy Chief Operating Officer in their investment business.

338. Mr. Percival has worked for 30 years in the financial advice sector, and since November 2016 has run his own training and consultancy firm. He worked for 19 years in financial advice firms, primarily undertaking compliance, technical support and training roles. He then worked for the FSA/FCA for ten years specialising exclusively in advisory firms. This work included extensive supervision of individual firms including all larger networks and many of the mid-sized networks. This did not, however, include any supervision of Sense, which was one of the few network firms with which Mr. Percival did not interact when he was at the regulator including over 20 years in compliance and regulation. Whilst at the FSA/ FCA between 2006 and 2016, he worked in what was called "thematic supervision". This involved focusing on a particular topic of concern:

his team would visit a number of firms in relation to that topic and assess firms in relation to it.

339. Both experts were clearly well qualified to give expert evidence on the issues which they addressed. I agree with Sense's submission that Mr. Percival had an impressive grasp of the subject and had the advantage over Mr. Morrey of having worked as a compliance officer in a network and for the FCA as a supervisor. Both of Mr. Percival's written reports and his oral evidence were thoughtful and carefully considered, and generally speaking I considered that he was a witness upon whom I could place reliance.

340. Sense criticised Mr. Morrey's evidence as being confused, contradictory, partisan and illogical, submitting that it should be rejected where it conflicted with that of Mr. Percival. I consider that in some respects there was a lack of consistency in Mr. Morrey's evidence. His written reports had in my view a tendency to make very sweeping criticisms of Sense. But, in many cases, these criticisms fell away either in the joint report, or as Mr. Morrey's oral evidence progressed.

341. For example, in the joint report Mr. Morrey accepted that it was reasonable for Sense not to have concluded (as a result of various incidents) that there was a culture of dishonesty at Sense, notwithstanding a number of issues relating to the integrity of the owners of Midas and their advisers. This contrasted with his written evidence that the various incidents "suggested a pattern of dishonesty was present within [MFSS]", and that "I do not believe a pattern of behaviour of this kind at any AR could have failed to lead to remedial measures by the Principal".

342. Similarly, Mr. Morrey's first report expressed the view that Sense "conducted its supervision in a hands-off and detached manner". This was in my view an extreme statement. By the time of the joint report, the experts were agreed that Sense's systems and controls framework were typical of the market and included the normal range of control measures. The principal issue between the experts, as articulated in the joint report, did not involve the sweeping criticism of Sense for conducting supervision in a hands-off and detached manner, but rather whether Sense had taken steps to identify if MFSS was undertaking activity for which it was not permitted; and specifically whether there should have been additional checks beyond review of files uploaded to I/O and review of the MFSS bank accounts.

343. An important area where Sense criticised the consistency of Mr. Morrey concerned the question of whether Sense did sufficient work to establish whether there were bank accounts additional to the account which MFSS had identified to Sense, and which Sense audited. In his first report, Mr. Morrey addressed this in paragraph 2.24 – 2.32, concluding that

> "It is my view that the steps to identify and inspect the bank accounts used by Midas are broadly in line with what I would expect to see during routine compliance visits. I have not seen any evidence to indicate to the compliance auditor that additional bank accounts may exist".

344. As discussed further below, however, Mr. Morrey in the joint report sought to backtrack from this and similar statements in his first report, albeit at the end of his oral evidence he ultimately landed at a similar point to the one at which he had started: "I would accept that doing further work around bank accounts to identify bank accounts is probably not the most productive means of identifying unauthorised business".

345. Despite these matters, I do not accept Sense's case that I should automatically reject any evidence given by Mr. Morrey in so far as it differs from that of Mr. Percival. It was in some ways to Mr. Morrey's credit that he moved away from certain extreme positions expressed in his earlier reports, and during the course of his oral evidence he was willing to accept many of the propositions which were put to him by counsel for Sense. It did not seem to me that his oral evidence was characteristic of a witness who had taken on the role of an advocate. Indeed, as a result of his approach, the disputed issues between the experts seemed to narrow considerably. There nevertheless remain a number of issues where the experts were in disagreement. Whilst, in view of his particular experience and greater consistency, I start with a preference for Mr. Percival's evidence on these issues, I think that it is important to evaluate the strength and logical force of the arguments on each side.

L2: Use of an in-house T&C Supervisor

The Claimants' submissions

346. As described in Section J above, Mr. Ingram was a "member" T&C Supervisor in that he was employed by AR itself and worked in their offices. His role could have been fulfilled by someone within Sense itself, as indeed happened when Mr. Owen took over in 2012. Both experts stated that in their experience the use of member supervisors is fairly common, and neither of them considered that the practice was improper or was to be criticised. Although at one stage Mr. Morrey expressed the view that he had "serious doubts" as to whether Mr. Ingram had sufficient knowledge and experience to fulfil the role of T&C Supervisor, this was another example of a situation where Mr. Morrey modified his views in the joint report. The experts were ultimately agreed that Mr. Ingram had adequate experience in the role of T&C Supervisor, and in my view rightly so: Mr. Ingram had fulfilled a similar role at Park Row, Mr. Netting knew his work, and there was no reason why, if a member supervisor was to used, Mr. Ingram should not be that person.

347. Nevertheless, and despite the expert evidence, the Claimants argued that the practice of using a member supervisor was itself a breach of the SUP rules. They submitted that the court should grasp the nettle and determine as a matter of law that on the true construction of the statutory SUP rules the use of member supervisors, or the near exclusive use of member supervisors for everyday or operational compliance, is not appropriate. The court should therefore over-ride the lax practice which it appears that the industry and the regulator is prepared to stomach. Nobody should be placed in the invidious position of Mr Ingram in this case. They contended that the use of member supervisors raises profound issues for the modern regulatory state, and if permitted across different sectors, would endanger life, health and wealth, premised as it is on irreconcilable conflicts of interest.

348. The Claimants therefore contended that Sense's supervisory team was small and fatally compromised by Mr. Ingram's role in it. Mr. Ingram was an employee of, and on the payroll of Midas, and not Sense, and therefore conflicted. Sense's supervisory team was infected by its reliance on him. The Claimants referred to certain differences between the perception of Mr. Ingram's role in the witness statements served on behalf of the Claimants and that in Sense's witness statements. They suggested that this showed that the staff at Midas did not have a clear understanding of who was responsible for compliance.

349. They also relied upon Mr. Morrey's written evidence to the effect that it was not appropriate for Sense to place any significant reliance for compliance on an employee of the appointed representative whose objectives and remuneration were set exclusively by MFSS. Mr. Morrey's written evidence was that it is a fundamental principle of sound compliance supervision that a principal firm cannot outsource its responsibility for ensuring compliance. Any scenario where Sense in fact relied on an employee of Midas to fulfil its compliance obligations was inappropriate whilst that individual remained remunerated and incentivised by Midas.

350. The Claimants submitted that as a matter of law the concept of an AR firm being entitled to carry out supervision itself, or allowed the choice to do it internally or "outsource" it to the network, was clearly inconsistent with the regulatory scheme.

Sense's submissions

351. Sense's short answer on this point was that the experts were agreed that there is no difficulty in principle with a T&C supervisor such as Mr. Ingram being an employee of MFSS provided that he was supervised; and that in the present case he was adequately supervised.

Analysis and conclusions

352. As set out above, there was no dispute between the experts on this issue. Mr. Morrey agreed in cross-examination that the use of a member supervisor was not uncommon. This would give rise to a risk, particularly if the individual had other roles to fulfill within that firm, that they would not perform their T&C role effectively. The way to mitigate that risk was to make sure that there was an effective level of supervision and monitoring of their performance. Mr. Morrey therefore agreed that there was nothing wrong with this model in principle, provided that there was a sufficient control in terms of supervision. Thus, the model did have potential risks or weaknesses, and it was appropriate to provide some mitigation in respect of them. Similarly, Mr. Percival considered that the model was FCA compliant, and that it was a question of managing the risk. When he worked at the FCA, he had seen the use of this model, and it was an acceptable model.

353. I consider that this approach (on which both experts were agreed) is sound, and that there is no basis for me to hold that the use of a member supervisor is automatically a breach of the SUP 12 rules.

354. If this model is adopted, there is a separate question as to whether the risk is properly managed, since it would obviously be necessary to ensure that the member T&C supervisor was himself adequately supervised. The Claimants did not contend that there

had been inadequate supervision of Mr. Ingram. But in any event, Mr. Percival was in my view correct to say that Sense took the appropriate steps to check the appropriateness of Mr. Ingram for the role, and there was appropriate monitoring of Mr. Ingram on an ongoing basis. There was a direct line of management of him by Mr. Painter and then Mr. Owen, and a direct line of communication between him and Sense that was used on a regular basis. In addition, Mr. Ingram's day-to-day work as T&C Supervisor, for example his 1-1 meetings with advisers, resulted in various written materials which were sent to Sense and reviewed.

355. Accordingly, I reject the Claimants' argument that the use of a member supervisor was itself a breach of the SUP rules.

356. I should add for completeness that I was not persuaded that there was a lack of clarity or confusion as to Mr. Ingram's role at MFSS. As between Sense and Mr. Ingram, this had been clearly set out in the Job Role document. The evidence of individual witnesses from MFSS, such as Mrs. Dowall and Mrs. Greig, amounted to nothing more than their subjective perception of what Mr. Ingram was doing and his role, and did not in my view demonstrate that there was any confusion as to what he was supposed to be doing, or what he was actually doing.

357. Finally, and in any event, I do not consider that the Claimants have sufficiently demonstrated any causal connection between the breach relied upon (using a member supervisor) and the consequence (the discovery and cessation of the scheme) which they need to establish in order to succeed in their claim for damages. The role of Mr. Ingram was effectively taken over by Mr. Owen in 2012, and he visited MFSS and spoke to the advisers and others on a large number of occasions particularly in the latter part of 2012. He continued to perform his role thereafter. Accordingly, during that period of time, Sense did adopt the model for which the Claimants contended. Nevertheless, the scheme was not discovered. There is in my view no reason to think that, particularly in light of the efforts that were made to conceal the scheme, it would have been revealed at an earlier stage if the Claimants' proposed model had been adopted.

L3: Managing risk where a member supervisor is used

358. The Claimants contended that if the Court was not minded to accept its case that the use of a member supervisor was impermissible, it was nevertheless common ground between the experts that the use of member supervisors results in heightened risks for the principal firm, and requires additional monitoring and supervision to mitigate those risks.

359. The Claimants submitted that Sense entrusted a significant proportion of its compliance and oversight function to Mr. Ingram, who was remunerated and incentivised by MFSS/Mr. Greig. This was a clear breach of SUP 12.4.2R, and in particular demonstrated that Sense did not allocate adequate controls (SUP 12.4.2R(3)(a)) or adequate resources (SUP 12.4.2R(3)(b)) to the supervision of MFSS. The additional controls were limited to checking bank accounts and company accounts, the rudimentary annual audit and remote checking. These were insufficient to mitigate the risks.

360. I considered that this argument to some extent re-stated the case (which I have rejected) that it was wrong for Sense to have used a member supervisor at all. The remaining aspects of this argument seemed to be me to raise the same questions as the Claimants' general case on insufficient monitoring of MFSS, which I discuss below. The engagement of Mr. Ingram as member supervisor is part of the contextual scene in which the question of whether MFSS carried out insufficient monitoring of MFSS is to be considered. As Mr. Percival stated, in my view correctly, the fact that a member supervisor had been employed meant that Sense would need to be alert to the wider scenario of what might be occurring within MFSS. So there would need to be other monitoring functions in place that assess the risk level within that AR, and appropriate action taken as a result. But this did not mean that there needed to be something specific in relation to Mr. Ingram (other than the need to supervise him properly) as a result of his engagement as member supervisor.

L4: Lack of monitoring

The Claimants' submissions

361. Overall, the Claimants contended that there had been over-reliance on virtual supervision through random file-checking via I/O. There had been a conscious policy choice not to undertake any checking of hard copy files or emails. This was driven both by a belief in technology and a policy decision not to commit resources. The file checking had been supplemented only by a routine annual audit and checking of the nominated bank accounts and company accounts. All of this was insufficient to meet the statutory requirement of reasonable steps under SUP 12. The Claimants contended that the steps taken would not have been appropriate risk management by a financial firm with a directly employed workforce spread over the UK. In reality, therefore, no effective or joined up checks were in place to mitigate the risk of Midas undertaking unauthorised business or handling client money.

362. The Claimants contended that Sense was responsible for its near-exclusive reliance on virtual supervision through I/O, limited supervisory visits by more senior compliance officers, and the policy decision to undertake no inspection of hard copy files. Mr. Netting accepted that Sense was entitled to seize hard copy files, but they did not do so.

363. In support of this case, the Claimants relied upon the views of Mr. Morrey, including his view that the issues raised by Sense would have merited a higher risk rating and a more intensive level of supervision. The Claimants referred to the guidance in SUP 12.1.3G that spelt out the regulator's legislative intention behind SUP 12 that the Claimants, as clients of Midas, are entitled to the same degree of investor protection as if they had been direct clients of Sense itself.

364. The Claimants accepted that I/O was a useful tool for financial intermediary networks. It gave 100% visibility to the principal of the information uploaded to it, permitted virtual scrutiny and monitoring, ranging from the random sampling of cases to 100% review. However, if random sampling was a valuable monitoring tool of electronic information, it is also a valuable tool for sampling of traditional record keeping. I/O was not a complete electronic record as it provided no "Sense Network" email server, and therefore Sense had zero visibility of Midas adviser's work email exchanges with clients.

365. The Claimants also relied upon the need for "face to face" supervision, as opposed to "desk-based monitoring". This was an important part of a "joined up supervisory strategy". They contended that it was difficult to discern how Sense did in practice assess the risk posed by MFSS. They said that in 2013/2014, supervision by Mr. Owen had become even more remote, using webinar or telephone.

Sense's submissions

366. Sense contended, in summary, that its systems and controls were adequate and were properly operated: there had therefore been proper monitoring of MFSS. They relied upon the evidence of Mr. Percival, emphasising that he had worked at the regulator a network supervisor and had worked as a compliance officer in a network. Mr. Morrey, by contrast had no equivalent experience. Leaving aside his reservations as to the way in which Accord issue was dealt with, Mr. Percival's evidence was that when one looked at all the evidence as to what Sense did in terms of collecting information and putting in place controls, and the way in which it dealt with issues that arose, his impression of Sense was that it was a very good firm.

> "I would say that of all the firms I visited, which number in the dozens, I would say that this firm [Sense] is in the top 10 or 20 per cent of firms. It is a very good firm, in my experience."

Analysis and conclusions

367. I accept Sense's arguments, and the evidence of Mr. Percival, on this aspect of the case. I therefore do not consider that the Claimants have shown that there was any breach by Sense of the SUP rules in relation to the monitoring of MFSS. Furthermore, even if the Claimants were right that there should have been some additional monitoring, such as checks on hard copy files, or some examination of e-mails, or some other steps such as additional customer contact, I was not persuaded that this would likely have revealed the existence of the scheme, particularly given the efforts of Mr. Greig and other MFSS personnel to conceal it from Sense. I expand on these conclusions below, starting with a number of general points.

368. First, it is important not to start from the premise or assume that the existence of the scheme is itself evidence that monitoring was inadequate. It was common ground between the experts that no supervision system can be expected infallibly to detect a fraudulent scheme. A well-designed and operated system exists to mitigate the risk of such scheme so far as reasonably practicable.

369. Secondly, as Mr. Morrey explained, this is not a case where the regulator or some other body has laid down guidance as to precisely how to define the control environment. Every organisation's processes will be different and there are different ways of designing the control environment.

370. Thirdly, as I have said, Mr. Percival had an impressive grasp of the subject and had the advantage over Mr. Morrey of having worked as a compliance officer in a network and for the FCA as a supervisor. In addition, having heard the evidence of Mr. Netting over a number of days, it was clear to me that he, and Sense overall, generally approached

the issue of compliance conscientiously and with a view putting in place, and then operating, sound systems which would protect the integrity of the firm which Mr. Netting himself had founded. This is consistent with the views expressed by the FSA in a letter dated 28 January 2011, following a desk based supervision review. This was a generally positive letter, and included the statement that:

> Overall, the firm's compliance monitoring arrangements appear to be adequate, with client files being reviewed on a regular basis and selected on a risk-based criteria, with those advisers or AR firms with a higher risk rating being subjected to increased levels of monitoring.

371. It therefore did not surprise me when Mr. Percival said that Sense was a very good firm, and was one of the top 10 or 20%. I consider that Mr. Percival's opinion in this regard was a view to which I should attach weight.

372. Fourthly, my view in this respect was reinforced by the fact that, as shown in the joint report and the oral evidence of Mr. Morrey in cross-examination, there were many important aspects of Sense's systems and controls which Mr. Morrey did not criticise. Indeed, it was common ground between the experts that Sense's systems and controls framework was typical of the market and included the normal range of control measures. Mr. Morrey thus had no material criticisms of the process of carrying out file reviews, identification of problems in those reviews, and addressing them. He said that the regime that Sense operated in relation to ARs, I/O and monitoring, and the risk-based focus of that monitoring and the follow−up of issues, seemed to be "entirely satisfactory". He explained that he had no issue with the way in which Sense structured the process and the level of work performed.

373. This endorsement of the file review process did not simply show that Sense sought to put appropriate systems in place. In addition, the file review process was an important aspect of Sense seeking to ensure that business was being conducted by MFSS in a manner which was compliant, and that unauthorised business was not being undertaken. The process involved examination of a very significant number of files; there was a review of around 25% or so of the approximately 3611 new business files uploaded during the period September 2007 to August 2014 (and a higher percentage if one looked at the files relating to investments rather than including mortgages). Yet, as Sense pointed out, there was not a single document on any of the very large number files reviewed, during that period of time, which was relied upon as alerting Sense to the existence of the scheme.

374. It is clear that there was a determined effort at MFSS to ensure that an important part of Sense's controls – namely the file review process performed through I/O – was effectively bypassed and did not reveal anything about the scheme. In that regard, a striking feature of the documentation was that that, in "fact-find" reports as to the investments of individual investors, the investment of monies in the scheme was either not referred to, or was referred to as a deposit with RBS; thereby omitting any reference to MFSS. But for this determined effort, it is likely that the existence of unauthorised business would ordinarily have been expected to be revealed by the file reviews.

375. Fifthly, although the Claimants made some criticism of the fact that Sense did not apply a single formula in order to rate each AR firm, and then determine the level of monitoring on that basis, I did not consider that this was a valid or relevant criticism.

Sense's approach was to consider different aspects of the MFSS's business and the performance of advisers by reference to its "Red Amber Green" rating. The latter rating controlled the frequency of 1-1s and also file reviews. Thus, a firm could be graded green at the annual audit, but a number of individual advisers might be graded amber or red as a result of the work done on their file reviews. I did not consider that there was anything wrong with an approach which looked at different parts of the overall business for the purposes of grading, rather than applying a single overall rating to a firm. It seems to me that this is very much a matter within the discretion of Sense, given that there are different ways of designing a control environment.

376. Finally, some criticisms were made of the frequency of visits by Sense to MFSS. However, Sense produced a table which identified some 58 visits to MFSS, for a variety of reasons including audit and training, during the period March 2007 to March 2014. Mr. Owen explained that Sense also arranged various events elsewhere, and that MFSS advisers would attend these. In these circumstances, it seemed to me that there was a very reasonable amount of "face to face" contact between Sense and MFSS over the years. This supplemented the work, such as file reviews and consideration of Mr. Ingram's reports, which Sense carried out on the documentation. It is true that after a period of frequent visits in 2011 and 2012, there were only three recorded visits in 2013 and one in 2014. However, I accept Mr. Owen's evidence that he was regularly in contact with MFSS advisers by telephone and webinar during that time.

377. Against this background, I turn to consider the key issues in relation to monitoring which divided the experts and which emerged in particular from the joint report and the oral evidence. Mr. Morrey's evidence was that the type and level of checking performed by Sense on cases uploaded to I/O was appropriate. But there were inherent limitations on remote file checking that needed to be addressed by other supervisory activities. These limitations related principally to the risk that cases would not be recorded on I/O and would therefore not be checked. Mr. Morrey considered that the monitoring carried out by Sense did not address the key risk that a client transaction was not recorded on I/O, and therefore was not subject to monitoring. He said that the audits were limited, and did not include testing that would have identified cases which had been excluded from I/O. Whilst Mr. Percival had identified the reconciliation of the designated Midas bank account as a key control by which Sense would identify business not recorded on I/O, Mr. Morrey had not seen evidence in the form of a "control objective" which described whether this control was indeed intended to mitigate the risk of unauthorised business being written by MFSS. Mr. Morrey considered that this control was only useful "if it is also conducted in conjunction with efforts to identify the full range of bank accounts utilised by Midas and to check those accounts for client related transactions".

378. In summary, Mr. Morrey considered that there was no evidence that Sense took steps to identify if Midas was undertaking activity which was not permitted. Whilst review of files uploaded to I/O and review of the bank account did have some value as controls, they did not address the risk that business was excluded from both these records. Additional monitoring was required: for instance a sample of physical client file checks, or sample checking of physical and email records to identify client transactions which may have been omitted. Mr. Morrey also referred to the possibility of additional client

contact, either with written questionnaires or phone calls, to get feedback from customers.

379. Mr. Percival disagreed. He considered that the controls which Sense used were typical and that there was no failure to meet FCA requirements. The systems were designed so that there was a strong incentive for advisers to record files on I/O. Thus, payments from providers for sales were reconciled with client file records in I/O, such that advisers did not receive payment if there was not an appropriate I/O record. Any payments without an appropriate I/O record would be investigated and this would highlight undisclosed business, whether authorised or unauthorised. Moreover, a large percentage of investment files (around 30-35%) were subject to review. Advisers did not know in advance which files would be reviewed and hence advisers knew that there was approximately a one in three chance of an investment file being reviewed. When a file was reviewed, if there were any elements missing then the adviser was required to upload them. Failures in record keeping could lead to problems for the adviser, for example additional monitoring.

380. Mr. Percival said that the framework therefore strongly encouraged compliant behaviours. Additionally, there was further checking by means of reconciliation of bank statements. In this way, all receipts into the MFSS bank account were reconciled with records on I/O and any discrepancies addressed. Hence, an AR such as MFSS was unable to be paid for business not recorded on I/O without this being found by Sense. The only way of circumventing these procedures required a large number of steps to take place. First, investments would have to be made in an unconventional or illegal way, wholly outside of normal relationships with providers of investments: since a legitimate investment provider would not take business from an individual AR without terms of business being agreed which would involve payment through Sense rather than rather than direct to Midas. Secondly, payments would have to be made into an account which was not the ordinary business account. Thirdly, it would be necessary for no records to be uploaded to I/O. And finally, there would be a need to conceal the arrangements from Sense.

381. I considered that the evidence of Mr. Percival on these issues, as summarised above, to be sound, and I prefer his evidence to that of Mr. Morrey essentially for the following reasons.

382. First, it was clear, on the evidence of both experts, that file reviews performed using the I/O system were generally superior to file reviews of hard copy files. Thus, it is impossible to remove documents from an electronic file once uploaded. If a document is altered, then the system leaves a trace: the documents uploaded to I/O are date stamped and provide a clear record of alterations made. This contrasts with hard copy files where, for example, is it not unknown for a document such as a suitability letter to be altered and then re-dated. The use of the I/O system therefore prevents the file from being "doctored" in the same way that a hard copy file can be retrospectively altered. In addition, the electronic record does not face the same risks of loss or destruction that exists for paper files which are sent to a warehouse or other storage facility. An electronic file can also be inspected by Sense, at any time, and without the adviser being aware that this is being done. This provides an incentive to the adviser to ensure that the file is complete and provides a disincentive to indulge in regular non-compliance with procedures.

383. Mr. Percival's evidence on this issue, which was not in dispute, was that even the smallest firms are now moving to a paperless system, and that the use of a paperless system has not been an issue for the regulator. Indeed, the vast majority of file reviews carried out by the FCA are "remote" file reviews.

384. Against this background, I was not persuaded by the argument that it was appropriate to carry out additional checks of such hard copy client files as may have been compiled by the advisers. Sense did carry out a large number of reviews of the files uploaded to I/O, where one would ordinarily expect the complete record to be contained. The problem in the present case is that the documents relating to the scheme were not contained in the client files that were loaded onto I/O. The key documentation relating to the scheme was sparse, consisting of: a file of hard copies of the confirmatory letters sent to investors; a spreadsheet maintained by Ms. Dowall; the occasional handwritten documents listing investors prepared an adviser, such as that prepared by Mr. Alexander; and the bank statements and bank books of the Midas Financial account which were kept by Mr. Greig. In order to uncover the scheme by looking at hard copy files, the relevant files to look at were not the hard copy client files. Rather, they were these other materials which Sense had no reason to believe existed. It was, however, common ground between the experts that it would not be part of a competent supervisory system for Sense to inspect the desks and briefcases of those at MFSS.

385. Accordingly, I was not persuaded that Sense can fairly be criticised for failing to review hard copy client files. Nor did the evidence show that any materials relating to the scheme were in fact contained on such hard copy files as were maintained. If the documents loaded onto I/O did not reveal the scheme, there is no reason to think that it would have been apparent from any review of hard copy client files.

386. Secondly, I attach importance, as did Mr. Percival, to the annual audit and the checks that were made on the MFSS nominated bank account. Thus, the file review process was not the only control that was put in place in relation to unauthorised business. Sense would obtain bank statements from the nominated business account of MFSS. These statements would be checked, with a view to identifying any entries which could not be matched to commissions which had been paid. Where such entries were identified, the evidence showed that Sense would ask questions as to the source of the funds. This approach was designed to highlight income that an AR was receiving outside of the AR agreement itself.

387. Mr. Percival's evidence was that this bank reconciliation process was undertaken robustly in practice, with entries being checked and ticked or questioned where necessary. At one stage in the course of cross-examination of Ms. Williams, it appeared that the Claimants might be contending that there were entries in the MFSS bank statements that would, if properly queried, have revealed the "Midas Financial – Aberdeen" account which was used by Mr. Greig to operate the scheme. However, this was not a point which the Claimants ultimately made in their closing argument, and there is no evidence that establishes that scheme monies were in fact ever directly paid into the MFSS nominated bank account so as to be identifiable and traceable as part of the annual audit. Mr. Greig was no doubt careful to ensure that such direct payments did not happen.

388. Given the detailed work that was carried out in relation to the MFSS bank account, the question arises as to whether there were further steps that Sense should have taken to

identify whether there were other bank accounts that MFSS was using. In his initial report, however – and consistent with the evidence of Mr. Percival – Mr. Morrey accepted that the checks carried out in relation to MFSS's bank accounts were sufficient. Thus, he said at paragraph 2.25:

> "Sense's approach to preventing Midas from receiving, holding and retaining client money is broadly what I would expect to see during a routine audit visit. I have not seen evidence to indicate to a compliance auditor that an additional bank account may have existed. The assets within the scheme account were held separately to the nominated company accounts of Midas. I would not expect this to have been uncovered as part of the reasonable supervisory activities by Sense".

389. Other passages in his first report were to a similar effect. In particular:

> [2.31] During audit visits the Midas bank account statements were checked. I do not consider that writing to RBS to confirm a complete list of bank accounts would be a reasonable part of an annual compliance visit exercise.
>
> [2.32] It is my view that the steps to identify and inspect the bank accounts used by Midas are broadly in line with what I would expect to see during routine compliance visits. I have not seen any evidence to indicate to the compliance auditor that additional bank accounts may exist.
>
> [3.75] … The assets within the Scheme account were held separately to the nominated company accounts of Midas, it is my opinion that this would not be uncovered within acceptable supervisory arrangements.
>
> [3.87] During audit visits the Midas bank account statements were checked … I do not consider that writing to RBS to confirm a complete list of bank accounts would be a reasonable part of an annual compliance visit exercise. Such an exercise would usually be completed as part of an external audit. As the account in question was held in a separate name to the company accounts then these further steps may not have identified its existence.

390. In the joint report, Mr. Morrey backtracked from these views, contending that it was critical to Sense's supervision to gain assurance on the existence of other bank accounts. His explanation for this change of heart was that he had not appreciated that this was a control being relied upon for the purposes of showing that there was no unauthorised business being written, as opposed to a control to ensure that client money was not going through the account. I was unimpressed by this explanation, since it would have been apparent to Mr. Morrey, at the time that he wrote his first report, that the bank reconciliation exercise was a control in relation to unauthorised business. I would therefore have expected Mr. Morrey to comment adversely on the adequacy of the control, for that purpose, if he had had any reservations about it.

391. I therefore prefer the evidence of Mr. Percival that Sense should not be criticised for proceeding on the basis that the bank account which they examined, as part of their audit, was the bank account that MFSS was using for its business activities. Indeed, in the final part of his evidence, Mr. Morrey fairly accepted that "doing further work

around bank accounts to identify further bank accounts is probably not the most productive means of identifying unauthorised business".

392. Thirdly, there was, as Mr. Percival pointed out, a further mechanism for monitoring the business activities of MFSS and hence whether it was carrying out activities outside the AR agreement. Sense reviewed income receipts that it received and reconciled these with its central records of business transacted. This was a further check for the completeness of the I/O record, since it would highlight any business transacted that had not been recorded on I/O, for example as a result of not having uploaded files.

393. In summary, there were various checks, and in particular the file reviews and the checks carried out in relation to MFSS's bank accounts, which were controls which, as Mr. Netting put it, would ordinarily have "raised a flag" in relation to Mr. Greig's unauthorised scheme, but for the efforts to conceal it. There were, as Mr. Netting explained, other matters as well which would be expected to raise flags. Sense's ARs would be asked to disclose other business interests each year. Checks would be carried out at Companies House in order to see if there were other directorships or roles being held. Sense would see at least the initial application by the AR for professional indemnity insurance, where questions would be asked by insurers which required full information about all the activities of each AR, including any separate business. In the present case, as Mr. Netting explained, the scheme was not revealed because it was well concealed.

394. Ultimately, the issue is whether Sense put in place and operated a reasonable control environment in terms of monitoring the activities of MFSS. Mr. Percival, who has considerable experience in this area, considered that Sense's control environment in terms of monitoring MFSS was reasonable. The Claimants have failed to persuade me to take a contrary view.

395. Furthermore, even if other steps had been taken as suggested by the Claimants, I was not persuaded that, on the balance of probabilities, the existence of the scheme would have been revealed. Thus, although reference was made to reviewing hard copy files rather than carrying out reviews via I/O, I was not satisfied that any information about the scheme would have been contained on the hard copy files. After all, as Sense rightly pointed out, determined efforts were made to ensure that nothing about the scheme was revealed on the documents that were uploaded to I/O, and there is no reason to think that any hard copy files would have been any more revealing. Similarly, even if (as Mr. Morrey suggested) the staff within MFSS should have been asked about the existence of other bank accounts used by MFSS, the overwhelming likelihood is that Sense would not have been told about the account that was used for the scheme. It was well understood within MFSS that Sense was not to be told about the scheme. Similarly, even if there had been some inspection of MFSS's email traffic, there do not appear to have been a significant number of emails passing between the advisers and the investors in relation to the scheme, and there is no real basis for concluding that a random inspection of emails would have revealed the existence of the scheme.

396. Equally, if there had been some further customer contact steps, such as further questionnaires or calls to customers on a sample basis (Mr. Morrey accepting that such contact steps would not be expected to involve the whole client base), I did not consider that that the scheme would, on the balance of probabilities, have been revealed. As Mr. Morrey accepted, there was no guarantee that the scheme would have been revealed by

additional customer contact, and it would all depend whether a sample landed on a relevant customer, and whether that customer then responded in a manner which revealed the scheme. This was rather borne out by the evidence that one of the investors, Mr. Lucas, was sent a questionnaire and (apparently because of the way in which his computer was set up) did not reply to it.

397. Accordingly, even if the Claimants had established any breaches of Sense supervisory duties in relation to monitoring, they failed in my view to establish that this was causative of the losses which the Claimants suffered.

M: Breach of Supervisory duties - failure properly to conduct investigations

398. The Claimants also contended that Sense was in breach of its supervisory duties under SUP 12 by reason of:

i) Sense's failure to carry out a proper investigation into an alleged mortgage fraud by Mr. Greig (in conjunction with Ms. Thomson and Mr. Laing) concerning mortgages provided by Accord on two flats in Glasgow; and

ii) Sense inadequate response to integrity issues relating, in particular, to the termination of one of the advisers, Mr. Jonathan Knowles.

399. The Claimants alleged that if there had been appropriate conduct in relation to any of these matters, the scheme would have been discovered and brought to an end. In relation to Accord, they alleged that if matters had been investigated properly, it would have resulted in the termination of the agency between Sense and MFSS, and the reporting by Sense to the FSA of the reason for that termination (mortgage fraud). In practice the Claimants contended, this would have been the end of the scheme, because Mr Greig would not have been able to obtain FSA authorisation.

M1: Accord Mortgages

Factual background

400. On 20 February 2008, Mr. Netting received a call from Ms. Sally Waddingham from the Accord Mortgages Financial Crime Risk Team. Accord was a mortgage provider within the Yorkshire Building Society, which is one of the largest building society lenders in the country. Ms. Waddingham advised Mr. Netting that she was limited in what she could tell Mr. Netting: the business in question was Park Row business, rather than Sense or Midas business. But she could say that Accord would be sending letters to say that Accord would no longer accept business from three individuals, namely Mr. Greig. Mr. David Laing and Ms. Sandra Thompson. She explained that it was not a decision that had been taken lightly. The decision had followed investigations into business that they had been involved with when they were at Park Row. She was, however, not willing or able to go into any detail at that stage, and suggested that Mr. Netting might want to sit down with them and discuss things.

401. On the following day, Mr. Newman emailed Mr. Netting to report on a conversation with Mr. Greig who was not a "happy bunny". Mr. Greig was up in arms about the letter received from Accord, and claimed to have no idea what it referred to, or what had caused it. Mr. Newman said in the email that he would "like to find out more to ascertain whether there is a real issue with, for example, a fraudulent mortgage case, or whether at the other extreme this is an error or misunderstanding at Accord". He added that whilst this did not relate to business conducted whilst at Sense or indeed Midas, "we do need to find out as much as possible and decide what steps might be appropriate for us to take".

402. Mr. Netting then spoke to Helen Barker, the Investigations Officer at Park Row, on or shortly after 21 February to see if she could provide any further information on the situation. Ms. Barker was then unable to do so, as she was in the process of searching for the files relating to the cases.

403. The issue was discussed at Sense's board meeting on 12 March. The minutes record: the concerns of the Board surrounding the refusal by Accord to service business written by certain advisers; Accord's initial refusal to give details because the business in question was Park Row business; and the fact that Mr. Netting had contacted the advisers in question and they had assured him that they had no idea why this may have happened. The board decided that Mr. Netting should write to Accord and Park Row with a formal request for more information.

404. On 19 March, Mr Netting wrote to Mrs. Waddingham noting the need for Sense to "discharge our responsibilities as a network, in getting to the bottom of this matter". He asked her to "release as much high-level information as possible to us in relation to the severance of business connection with these individuals. Any information you can provide would be gratefully received."

405. Mr. Netting spoke to Mrs. Waddingham again on 3 April 2008, and she suggested that Mr. Netting should obtain the individual authority of the advisers to discuss matters with her. In due course, this authority was obtained.

406. On 18 April the matter was discussed again at Sense's board meeting. Mr. Netting reported that he had written formally to both Accord and Park Row to request information surrounding this situation, and responses have been chased. He reported that statements had also been obtained from the individuals concerned and records had been made in full. By the time of the trial, however, these statements could not be located.

407. Mr. Netting also told that board that, during a phone call, Park Row said that they had "no real evidence in relation to Accord's complaint that they have on record", and that Mr. Netting had requested that this be documented in writing to Sense. This statement to the board was based upon a conversation between Mr. Netting and Ms. Helen Barker at Park Row. Mr. Netting had previously worked with Ms. Barker. Again, however, by the time of the trial there was no record of Park Row having provided this confirmation in writing.

408. There was some delay in moving matters forward because of mis-addressed post, but there was an important development on 30 April 2008. Mrs. Waddingham e-mailed to Mr. Netting on that day setting out the issues which concerned Accord. This was the

first time that Mr. Netting received any detailed information explaining Accord's decision. The material part of the email was in the following terms:

> The issues we had related to the fact that the advisors were fully aware that Accord did not provide buy-to-let mortgages however, Thomson and Greig (his application was made via David Laing) obtained mortgages via Accord, for flats in a block in Glasgow that has now gone "pear shaped". It is clear that the flats were bought for investment purposes specifically as they were both residing in Aberdeen at the time and remained working there. They did however declare that the flats would be used for their main residence and received a preferential rate of interest of 4.99% and with the alleged cashbacks being provided, in truth probably obtained a 100% loan, although on paper it appeared to be 85%. Both borrowers have remained living at their previous addresses with their spouses and there is no evidence they have ever resided at the flats. The cases were done on a self-cert basis and there are discrepancies with Greig's earnings which were declared on the application compared with what I believe he was earning whilst self-employed at Park Row.
>
> Currently there are approximately 100 flats empty within the block which is in extremely poor state of repair with lifts/doors entry system broken and a dead body even being found in a corridor. We had 4 possession cases go to auction last month and the highest price offer was £70K when the outstanding mortgages were around £175K+.
>
> Both Greig and Thompson are making payments on these mortgages but I am worried as to whether this will be sustainable when their current 4.99% product expires next year. I don't know whether the flats are tenanted at the moment.
>
> Accord feels that the integrity of the brokers is in doubt as they have knowingly obtained a residential mortgage when the property was clearly being obtained for letting/investment.
>
> Accord is now left bearing the higher risk of this type of mortgage and had we known the true position, the mortgage would not have been granted.
>
> There are lots of different strands to this matter and it is clear that other mortgages obtained in this block have been obtained fraudulently, although these do not relate directly to Greig/Laing or Thompson. If you wish to contact me to discuss the matter in more detail please feel free to give me a call.

409. Subsequently, Mr. Netting went to interview the three advisers about the allegations. He interviewed them separately. This was done on a visit to Aberdeen on 27 May 2008

when Mr. Netting also dealt with other business matters. Some time afterwards, Mr. Netting prepared a document headed "Investigation meeting notes": one version of this document is dated August 2008, but it was unclear whether the document had originally been prepared earlier than that. At all events, the notes summarised what Mr. Netting had been told. The material part of the notes were as follows:

> **Investigation Meeting Notes**
>
> Advisers: Alistair Greig, Sandra Thomson and David Laing
>
> **Background**
>
> The investigation is in relation to the withdrawal of agency by Accord Mortgages in relation to the above named advisers and the provision of information (see attached).
>
> The main accusation is that whilst authorised via Park Row, Alistair Greig and Sandra Thomson both purchased flats using Accord Mortgages as residential when in fact they intended to use them as buy-to-let. David Laing is involved as the mortgage for Alistair Greig was in fact submitted under his name.
>
> Furthermore, they state that Alistair Greig inflated his earnings and that they do not match his earnings at Park Row.
>
> Park Row have closed their investigation and stated that they did not find against the advisers due to lack of evidence and have verbally confirmed that they are unable to confirm the accusations made by Accord.
>
> While the accusation are in relation to transactions prior to the individuals' authorisation with Sense Network as carried out under authorisation at Park Row. However as Accord made us aware of their suspicions, and as such activity could call into question the individuals' fitness and propriety, it was decided that Sense Network would carry out its own investigation.
>
> **Advisers Response**
>
> The advisers maintain that both flats were purchased as residential. The reason this was not disclosed to Accord when questioned directly was due to the sensitive nature of the reasons for their needing second properties in Glasgow.
>
> At the time of the purchase a number of individuals within Park Row (led by Alistair Greig and Sandra Thomson) were intending to break away from Park Row and set up their own business.
>
> A company had been registered called Park Row Scotland Ltd and the individuals were in talks with Sesame Network Ltd regarding this becoming an AR firm. The plan was for the majority of Park Row advisers in Scotland to join this business

and talks had progressed to the stage that Alistair plus his team from Aberdeen as well as a number of the Glasgow advisers had decided to move.

On this basis when the opportunity came up to purchase two flats in Glasgow, Alistair and Sandra decided that as they would have to spend a significant amount of time in Glasgow running this new business they would buy them as second residential properties.

Unfortunately, after contracts had been signed with Sesame, Park Row became aware that this was happening, (partly due to the registered name) and immediately started proceedings to stop it.

This resulted in the use of the Park Row mark clearly not being allowed and while the Aberdeen team still left the Park Row and set up Midas, the Glasgow advisers decided not to leave with them.

As a result both Sandra and Alistair no longer needed residential property in Glasgow. However, the purchase had already completed and the mortgages were already set up on a residential basis.

Both Alistair and Sandra did use the flats personally during this period while working on setting up the business and did not rent them out until after the plans changed. The properties were purchased in January 06 and not rented out until May/June 06. These dates match the period while setting up Park Row Scotland and subsequently Midas.

Clearly due to contractual reasons this was difficult to disclose to Accord and as the intention was to open an office in Glasgow as soon as possible they decided to temporarily rent the flats out.

During this period due to external factors conspired against them in that the Glasgow adviser did not follow so the opening of a Glasgow office was delayed. Furthermore, due to issues with the block of flats itself (flats being empty led to them being becoming misused and in disrepair) the value significantly dropped.

This resulted in Alistair and Sandra being in a Catch 22 situation as they couldn’t sell the property for the amount over the outstanding mortgages, nor could they switch the lending to buy-to-let as the rental amounts would not have been sufficient. As a result while they accept that they should have notified Accord they decided to attempt to sit it out and rent them out when they could.

> Both individuals have lost significant funds on the flats as a result, however they have always maintained the mortgage payments.
>
> …
>
> Regarding the Accord accusations regarding Alistair inflating his earnings, this is understandable as it is understood that they are based on Park Row earnings alone. Alistair also has significant earnings from a significant buy-to-let portfolio and holiday home/caravan lettings. Taking this additional income into account it is more than sufficient.
>
> It is also worth noting that as both Alistair and Sandra have a number of buy-to-let properties this would also appear to validate their explanation as why would they not have included the flats in question within their portfolios unless they did genuinely intend to use them for residential purposes.

410. In summary, Mr. Netting was prepared to accept the advisers' explanation that the flats were intended to be for work purposes. This explanation was in essence that the flats had been bought for residential purposes at a time when Mr. Greig and others were planning to leave Park Row and form a business called Park Row Scotland. This business would have a Glasgow office, and Mr. Greig and the other individuals anticipated spending much time working in Glasgow. In accepting the explanations, Mr. Netting drew upon his personal knowledge, derived from his time at Park Row, of the events described by the advisers concerning their planned departure from Park Row, and how their plans had been prevented by Park Row. Mr. Netting also accepted Mr. Greig's explanation for the earnings figures.

411. Mr. Netting's evidence was that he was satisfied that he had carried out an appropriate investigation, and that Mr. Greig, Mr. Laing and Ms Thomson had supplied a credible and coherent explanation for the issues raised by Accord. He considered that he was entitled to rely upon what he was told by Park Row as to the results of their own investigation. Park Row had a duty to investigate, since the relevant transactions occurred whilst the advisers were there, and Mr. Netting knew the individuals responsible for the investigation. Mr. Netting also said that he discussed his findings with other members of the Sense Board, including Mr. David Bratessani. Mr. Bratessani had been a regulatory supervisor, and Mr. Netting placed great store by his judgment and experience, as a cross check of his own conclusions. At no stage did Mr. Bratessani suggest that any further action was required. Mr. Netting reached his decision in June after discussing the case with Mr. Bratessani, albeit that he may not have written up his notes until 7 August.

412. Mr. Netting therefore concluded that the advisers had provided a plausible explanation for their actions and that they were therefore not lacking in integrity. His evidence was that if he had discovered or been provided with incontrovertible evidence that the advisers had deliberately deceived Accord when making the applications in question, he would have terminated their authorisations without hesitation.

The Claimants' submissions

413. The Claimants contended, supported by Mr. Morrey, that the investigation was inadequate. The relatively detailed allegations of false mortgage applications – which led to the three individuals being barred from the panel of one of the UK's leading lenders – necessitated an independent and objective inquiry by Sense and Mr Netting as to whether these three key players had the requisite fitness and propriety to be entrusted with providing financial products to the public under the Sense banner. That inquiry could not be out-sourced to anyone.

414. The Claimants relied upon the fact that Mr. Percival's reports indicated that he had always been uncomfortable with the conduct of the investigation. They referred to Mr. Percival's first report where he said that it was not clear to him why the advisers' explanations were considered entirely acceptable given that (a) Mr. Greig and Ms. Thomson did not switch their mortgages to buy to let when they let them out, and (b) the mortgage applications were on the basis of the properties being principal residence and it was not clear whether this was in fact the intention. Mr. Percival also commented adversely upon the length of the investigation: nearly 6 months from first being informed to completing the investigation notes.

415. The Claimants went so far as to contend that Mr. Netting allowed his own integrity to be compromised by, at the very least, turning a blind eye to what were demonstrably integrity failings; and that he must have been aware that the advisers had not been straight with him in initial denials that they had no idea what the panel ban was about. But in any event, Mr Netting failed to take reasonable steps to conduct the investigation into the three individuals' fitness and propriety to provide regulated financial advice. At its core Mr Netting should at least have obtained the underlying documents (the application forms) from either Park Row or Accord, or contacted Mrs Waddingham (pursuant to her express invitation) having obtained the individuals' account of their actions, or both. Even if the explanations were plausible, such plausibility only establishes the threshold of a credible explanation which requires further enquiry to verify or falsify it. The investigation could not proceed without some objective and independent evidence.

416. The Claimants also contended that Mr Netting's evidence about his understanding of the state of play with the Park Row inquiry lacked any real particularity, and was not credible. He could not identify on cross-examination which Park Row individual (Helen Barker or Gary Maude) had allegedly told him that the investigation had concluded for insufficient evidence. There was no documentary evidence from Park Row to support it.

417. As far as causation was concerned, the Claimants submitted that a competent investigation would have established blatant, self-enriching mortgage fraud, or abetting such conduct, and therefore a manifest lack of integrity. They argued that Mr Netting fairly accepted he would have terminated the three individuals and therefore in effect the whole of MFSS. It was irrelevant that, as emerged from the evidence, certain MFSS advisers, such as Mr. Malcolm Laverock, had continued to work on mortgage advice notwithstanding their actual or potential involvement in the scheme. Sense would have had to give an adverse reference for Mr. Greig following termination. Termination would have stripped away the badge of respectability from MFSS, and that in all probability would have prevented further fraud and mis-selling. The FSA would have

been alerted to the issue, and Sense (when asked for references) would have been alert to ensure that no other respectable financial institution took on any of those directly involved, and would have cautioned those who dealt with those who may have been peripherally involved. If another authorised person had then taken on Mr. Greig, in the face of an adverse reference from Sense, he would be back in the regulatory system – and any individual dealing with him who suffered loss would have a right of recourse against his new authorised firm, at the very least for breach of initial due diligence under SUP 12.

Sense's submissions

418. Sense contended that Mr. Netting had carried out a reasonable investigation and had reached a reasonable conclusion. Mr. Percival's view was that whilst Mr. Netting could have asked for more information, and that had he done so he would probably have found out reasonably quickly that some of the explanations were implausible, it was not a case where Mr. Netting "should" (rather than "could") have asked for more. In Mr. Percival's view, it was reasonable for Mr. Netting to stop where he did: he should only have taken things further if there were question marks over the explanations given. But where the explanations were sensible and rational, and the investigator had no other suspicions, then "it would be reasonable to stop at that point". He acknowledged, however, that Mr. Netting's investigation was "not his finest hour."

419. Sense submitted that Mr. Percival's evidence should be accepted. He had thought very carefully about the issue, and had ultimately concluded that Mr. Netting had done enough. This was supported by the following principal points:

i) Mr. Netting was entitled to place a fair amount of reliance on what he was told by Park Row. Park Row had a duty to investigate, even though these individuals were no longer there, and they had to tell Mr. Netting frankly what they had discovered. Park Row were in the best position to look at the file: they had investigated and were not taking the matter further because of a lack of evidence.

ii) Mr. Morrey's evidence as to the importance of obtaining the application form was hindsight driven. He only made that point in his third report, after the application form had been obtained by way of third party disclosure and it was apparent what it said.

iii) When Mr. Netting was told, at his May interviews with the advisers, that the reason for buying the flats was the Park Row abortive break-away, he did not need to investigate with Park Row to see if there was any truth to what was being said. He had personal knowledge of the break-away, and how this was prevented by Park Row at the time. Therefore he would have found the explanation plausible. He had also been given to understand by Mrs. Waddingham that the flats had not been let immediately, but only after a period of time. This too added plausibility to the account which he had been given: namely that the intention originally was to occupy the flats.

iv) The focus of Mrs. Waddingham's complaint, and her email of 30 April, was that the advisers had bought the flats as buy-to-lets, and they were never going to live there. This was what Mr. Netting had reasonably focused on, and given his

knowledge of the Park Row breakaway, he was satisfied with the explanation that the advisers had intended to live in the flats.

420. Sense submitted that there was a very real danger of hindsight in considering this issue: i.e. that it is now known that Mr. Greig was dishonest and running a Ponzi scheme. But this was not something known at the time.

421. In relation to causation, Sense submitted that even if Sense had terminated the advisers concerned (or MFSS as a firm) the scheme would still have operated and the Claimants would still have lost their money. They relied upon various factors:

i) Like any Ponzi fraudster, Mr. Greig had to keep the scheme going. The consequences of its cessation would have been (and have in fact been) professional ruin, bankruptcy and criminal charges. He would therefore have sought to operate the scheme even without MFSS being an AR of Sense. For Mr. Greig, the stakes could not have been higher

ii) Mr. Greig did in fact seek to operate the scheme even after termination by MFSS and even after the scheme bank account was frozen.

iii) Mr. Greig continued to write letters relating to the scheme, after termination by Sense, simply causing Mrs Greig to remove the reference to Sense from the notepaper used.

iv) Mr. Greig was unquestionably "the boss" of MFSS. The evidence showed that he was an accomplished and persuasive liar and manipulator of others. Mrs. Greig had described him as a "very very controlling man, no-one would dare not do what he said".

v) Had he needed to do so, Mr. Greig would have operated behind the front of a "phoenix" firm in which associates from MFSS would have occupied the regulatory positions. Sense relied upon the evidence of Mr. Percival that it would be reasonably straightforward for MFSS to reinvent itself in another format. There was a practice referred to in the market as "phoenixing": where a firm had, for whatever reason, got into trouble, it would be closed down and a new firm would then be set up with a similar name. This was by no means unusual. The ability to stop one firm and start another firm, when "you've done some bad stuff" was perfectly feasible, and happens quite often.

vi) Mr. Greig did not actually need the "halo" provided by a regulated firm. Generally speaking, the Claimants had not relied on the regulated status of MFSS when depositing their money. They relied on personal connections and/or the relationship of trust and the expectation of fair dealing prevalent in the Aberdeenshire community (as attested to by several of the Claimants witnesses). They had all handed over large sums of money prior to receiving the letter confirmations that contained the reference to Sense.

vii) Had any participant questioned the absence of a regulated firm apparently connected with Mr. Greig's operation, Mr. Greig would have concocted a satisfactory explanation. Alternatively, Mr. Greig would simply have repaid any

depositor who asked awkward questions, as he did when Mr Ingram insisted that all his clients be repaid and "got out" of the scheme.

422. Sense therefore submitted that the evidence and the inferences to be drawn therefrom supported the proposition that the scheme had to continue, by any means necessary. Mr. Greig would have done so unless and until the FSA/FCA took action upon its discovery (as in fact eventually happened, because of the response of Sense to the whistle-blower notice).

Analysis and conclusions

423. The relevant SUP rule relied upon by the Claimants in relation to Accord Mortgages was SUP 12.4.2 (2) (b):

> "Before a firm appoints a person as an authorised representative and on a continuing basis, it must establish on reasonable grounds that
>
> (2) the person
>
> (b) is otherwise suitable to act for the firm in that capacity"

424. I agree with the Claimants' submission that suitability for an AR firm meant that its individuals are fit and proper within the regulatory meaning of not lacking integrity. The relevant question (leaving aside issues of causation) therefore is whether, in the light of the matters which Accord brought to his attention, Mr. Netting did "establish on reasonable grounds" the suitability of Mr. Greig and the other two advisers. If not, then there would have been a breach of the relevant rule and potential liability.

425. I unhesitatingly reject the Claimants' attack based upon the integrity of Mr. Netting's investigation. It is clear from the documentary evidence that Mr. Netting was concerned to investigate the issue raised by Accord, and that he did so. I have no reason to doubt that the documents that he wrote at the time, or statements which he made to the Sense board, did fairly reflect what he had been told. In particular, there are two references to discussions with Park Row: in the board minutes of 18 April, and in the investigation notes. I consider that these references contain the gist of what he was told by Park Row.

426. The question remains however as to whether Mr. Netting did enough to meet the obligation of establishing "on reasonable grounds" that the relevant individuals were fit and proper in the sense of not lacking integrity. I consider that this is a finely balanced issue, with forceful arguments on both sides. I also agree with Sense that it is important not to look at this issue with the wisdom of hindsight. On balance and whilst (as Mr. Percival accepted) Mr. Netting clearly could have done more, I consider that Mr. Netting's investigation was sufficient, in all the circumstances, to meet the requirement of establishing "reasonable grounds". My reasons for this conclusion are as follows.

427. First, I consider that Mr. Netting reasonably focused on the central allegation that had been made by Mrs. Waddingham in her e-mail of 30 April 2008: "Accord feels that the integrity of the brokers is in doubt as they have knowingly obtained a residential mortgage when the property was clearly being obtained for letting/ investment". In relation to that allegation, he questioned each adviser separately and received a detailed

explanation relating to the circumstances of the proposed departure of the advisers from Park Row. I agree with Sense that it is important to recognise that Mr. Netting himself knew about the very events that the advisers were describing, and he concluded that the explanation made sense and was acceptable.

428. In addition, Mr. Netting had been told, as his investigation notes state, that:

> "Park Row have closed their investigation and stated that they did not find against the advisers due to lack of evidence and have verbally confirmed that they are unable to confirm the accusations made by Accord"

I consider that Mr. Netting was entitled to rely upon this information as part of his investigation, and as confirmation of the view which he formed after meeting the advisers. Because the relevant matters had occurred whilst the advisers were at their former firm, Park Row did have its own duty to investigate and to inform Mr. Netting of any adverse conclusions. Mr. Netting's evidence was that he spoke to two individuals at Park Row: Ms. Barker, whom he had recruited, and his opposite number Gary Maude, who had a good reputation and with whom Mr. Netting had previously dealt. He said that he had no doubt that they would have done a thorough job. The documentation relating to the mortgage transactions was at Park Row, and I consider that Mr. Netting could reasonably believe, and did believe, that it had been looked at by competent individuals at the firm which had its own duty to investigate.

429. In these circumstances, I consider that it is understandable and reasonable for Mr. Netting to consider that there was insufficient foundation for the allegation that the advisers had knowingly obtained a residential mortgage when the property had in fact been bought for buy-to-let purposes.

430. Secondly, I accept Mr. Netting's evidence that he did speak to Mr. Brattesani, who was an ex regulatory supervisor, and that they talked through what Mr. Netting had done and his findings. Mr. Brattesani's view at the time was that Mr. Netting had undertaken a reasonable investigation and did not need to take further action. This view, expressed without the benefit of hindsight, is of some weight in assessing whether or not there was a failure at the time to establish "reasonable grounds".

431. Thirdly, against this background, I do not think that it was incumbent upon Mr. Netting to try to obtain the application form itself. I consider that the Claimants' argument in this respect is dependent upon the benefit of hindsight. Mr. Morrey's first and second reports did not refer to the necessity to obtain the application form, but rather made the generalised assertions that Sense "should have taken their investigation further", and criticised Sense for relying on the views of the individuals under investigation. Nor was this point made by Mr. Morrey in the joint report served on 6 February 2018. The arguments as to the need to "request supporting information and analysis" from Yorkshire Building Society, and the focus on the application form itself, were raised and developed only after the application form had actually been obtained by way of a third party disclosure order.

432. It is true that had the application form been obtained, it would have become quickly apparent that the explanations provided by Mr. Greig did not stand up to scrutiny. This is because there was an express representation not only that the Glasgow flat would be

Mr. Greig's "main residence", but also a statement in a covering fax which represented that Mrs. Greig would be residing at the property and referred to "confirmation of expected rental at Cairnbuig". Mr. Greig's explanation to Mr. Netting was that the flats were to be used during the week, effectively as pieds-a-terre. But Accord had been given to understand that Mr. and Mrs. Greig would be moving to Glasgow, and renting out the very substantial 26-room house at Cairnbuig which Mr. Netting had himself visited. Mr. Netting, had he seen the covering fax, would have appreciated that this was untrue. Equally, the application form would have revealed the fact Mr. Greig's explanation for the discrepancy in his earnings was untrue or at least very doubtful: since the application form asked, separately, for details of employed income, self-employed income, and other income such as rental income.

433. In reaching my conclusion that Mr. Netting did enough, I have specifically considered whether two specific aspects of the information provided by Mrs. Waddingham should have led Mr. Netting to press for further information.

434. First, her email referred to a number of reasons why she had concluded that the mortgage application should not have been a residential application. These included the statement that the advisers "did declare that the flats would be used for their main residence". The Claimants can reasonably argue that Mr. Netting should have looked further into this particular statement, particularly because he knew that Mr. and Mrs. Greig lived in a very large property and that they would continue to do so, with Mr. Greig using the Glasgow flat as a pied-a-terre. However, the thrust of Mrs. Waddingham's email, and the specific reason why the integrity of the brokers was doubted, concerned the issue of whether the intention had been to reside in the property at all, or to let it out. It was this issue upon which Mr. Netting was focused, and I consider that it would be harsh to hold that, viewed overall, Mr. Netting failed in his "reasonable grounds" obligation by failing to ask further questions about the "main residence" statement which was not the focus of Mrs. Waddingham's concerns. In addition, there is some ambiguity about the concept of "main residence"; an expression which could be taken to refer to the place where a person lives for most of his time. Mr. Netting believed that Mr. Greig would be spending the working week in Glasgow.

435. Secondly, the Claimants can reasonably argue that Mr. Netting too readily accepted Mr. Greig's explanation for the earnings figures which he had given; i.e. that his earnings had included his buy-to-let income. Mr. Netting agreed that he knew that mortgage lenders usually distinguish in their forms between different income streams, asking for information about each. He said that this was clearly not a point which occurred to him at the time. Again, I think that it would be harsh to conclude that Mr. Netting's failure to reject this explanation meant that, viewed overall, Mr. Netting failed in his "reasonable grounds" obligation. The explanation given seemed a plausible one, since Mr. Netting knew that Mr. Greig had income from a buy-to-let portfolio. Again, it is important to note that the overstatement of income was not the central point that Mrs. Waddingham was making, and it was not given as the reason for doubting the integrity of the advisers. Moreover, in this context too Mr. Netting was entitled to rely upon the information that he had received from Park Row, as recorded in his investigation meeting notes, as to the closure of their investigation, that they did not find against the advisers, and that they were unable to confirm the accusations made by Accord.

436. However, even if I had concluded that there was a breach in relation to Accord, I consider that the Claimants have failed to establish, on the balance of probabilities, that

this caused their relevant losses. The Claimants' pleaded case, as set out in paragraph 73A and 76 of the Amended Particulars of Claim, is that Sense should have terminated the MFSS's AR status, and/or notified the FSA/ FCA of the issues with MFSS and/or terminated the status of Mr. Greig and other representatives of MFSS as approved persons. This would have meant that the investors would not have suffered loss because, if properly advised, they would not have contributed to the scheme.

437. On the basis of Mr. Netting's evidence, it is clear that if he had concluded that the three advisers had committed mortgage fraud, Sense would have terminated the AR relationship with MFSS. But the question is: what would then have happened?

438. I do not consider that the Claimants have established, on the balance of probabilities, that this would have led to the closure of the scheme. I agree with Sense that Mr. Greig would have tried to find ways to keep it going. I also consider that he would have received support in that endeavour from the other advisers within MFSS who were promoting the scheme, and who were receiving commissions in respect of the monies invested. There were therefore strong incentives to keep the scheme going.

439. I also consider, on the evidence before me, that there are a number of ways in which the scheme could have continued to be operated. When asked whether termination of the AR relationship would have decapitated Midas and brought "this business to an end", Mr. Netting disagreed. He thought that "they would have continued to trade with the other directors somewhere". It seems to me that this is a very likely scenario, particularly bearing in mind that the office infrastructure for MFSS existed, MFSS had previously been a directly authorised firm, and most of those advisers who worked for MFSS were not implicated in the Accord matter. It would not have been too difficult for Mr. Greig to have persuaded the advisers to continue to operate the MFSS business, including the scheme, with Mr. Greig in the background.

440. Furthermore, the evidence indicated that even those who were implicated in the Accord matter would not necessarily have had their careers ended. Mr. Netting's experience was that many advisers who have been de-authorised by one organisation succeed in getting re-authorised elsewhere, including directly authorised by the regulator. This evidence was supported by Mr. Percival, who also explained that it was common, if a firm had got into trouble, to close down the firm and then start a new firm.

441. It is for the Claimants to prove, on the balance of probabilities, that termination of the AR relationship between Sense and MFSS would have brought the scheme to an end. I consider, however, that it is more probable that, one way or the other, Mr. Greig and others at MFSS would have found ways in which to continue to operate, and to operate the scheme, notwithstanding termination of the relationship.

442. Towards the end of the evidence, and in their closing argument, the Claimants began to develop an argument that if the scheme had continued, they still suffered a relevant loss; essentially because they would have had rights of recourse against any regulated entity that had carried on the business of MFSS or which had taken on its advisers. For example, if Mr. Greig had been taken on by another authorised person, he would be "back in the regulatory system". However, it did not seem to me that this alternative way of putting the case on loss fell within the scope of the Claimants' pleaded case, which was based upon the premise that the investors would not have invested their money in the first place. I also consider that the question of what rights of recourse

might have existed – for example whether there would be rights under the FSCS in the event of an insolvency – is remote from the issues which were pleaded and to which the evidence in the case was directed.

M2: Jonathan Knowles and other matters

The factual background and the parties' submissions

443. In March 2012, following an email from Santander and a request from Mr. Newman to investigate, Mr. Netting discovered that Mr. Knowles had been processing mortgage applications generated by a local agent called Aberdeen Mortgage and Property Management ("AMPM"). It seemed that Mr. Knowles had not met any of the applicants. The effect of this was that AMPM were providing mortgage advice without authorisation, and that Mr. Knowles was processing business without himself giving any advice to the client as well as taking business from an unauthorised introducer. Mr. Netting consulted with Mr. Newman and decided to suspend Mr. Knowles immediately from acting as a mortgage adviser. He informed Mr. Greig and Mr. Ingram of what he had discovered, and they took immediate action to secure all documents and files on Mr. Knowles' desk and sent them to Mr. Newman. Mr. Ingram also arranged for these files, where appropriate, to be uploaded to I/O.

444. Mr. Netting sent details to a number of different lenders to find out whether applications had been submitted via themselves. He also informed the FSA of what had occurred and also reported the matter to the Serious Organised Crime Agency ("SOCA"). In interview with Mr. Netting, Mr. Knowles confirmed that he had been processing applications from AMPM without having met the customers. He did not believe that he had been causing harm to customers, and Santander confirmed to Mr. Netting that there was no evidence of client detriment. Nevertheless, Mr. Netting had no hesitation in terminating Mr. Knowles' authorisation as a mortgage adviser with effect from 23 March 2012 because of a gross breach of Sense's procedures. Subsequently, MFSS terminated Mr. Knowles' contract as a self-employed mortgage adviser.

445. Mr. Netting then carried out a full investigation into customers who might have been advised by AMPM but had submitted applications via Mr. Knowles at Midas. This involved contacting lenders and customers. Where any customer detriment was identified, Sense and MFSS reimbursed any costs or losses that the customer satisfied.

446. The FSA requested that Sense send the client files relating to these cases to them. This was done. Having reviewed the files, the FSA returned them directly to Midas. The FSA did not raise any further issues following their review.

447. By the time of the trial, the Claimants no longer contended that this episode should have led Sense to recognise that there were systemic problems within MFSS. Rather the focus of the Claimants' argument was that the investigation into Mr. Knowles' activities was too narrow. Mr. Morrey's view was that there should have been an investigation into all of Mr. Knowles' business. The severity of the issues, and the lack of integrity and honesty which they evidenced, should have led Sense to perform a wider review of Mr. Knowles' interactions with clients, including reviewing their correspondence and potentially meeting with clients directly to identify, and then be able to rectify, other examples of misconduct that might have existed. Essentially this would have constituted a past business review of the activities of Mr. Knowles. Had this happened,

the scheme would have been revealed; because at least one individual (Mr. Lucas) had been introduced to the scheme by Mr. Knowles and there had been correspondence with him.

448. Mr. Netting's evidence as to his approach at the time was that the AMPM issue was a very isolated issue which Mr. Knowles had foolishly allowed himself to become involved in. His investigation revealed that the connection with AMPM had been very recent, and that the mortgages submitted had only been going on for 2-3 months. Mr. Netting's review was focused on identifying all clients who might have been introduced by AMPM. This involved reviewing the files seized from Mr. Knowles' desk, reviewing records on I/O and enquiring of lenders to see if there were other clients where applications had been submitted. Letters were sent to all of these clients although in the event there were only two clients who were unhappy with the advice given by AMPM.

449. Mr. Netting's view and evidence was that it was not reasonable or proportionate to have conducted a full historic review of all advice given by Mr. Knowles. Apart from one breach of Sense's pre-approval procedure, Mr. Knowles had an acceptable compliance record and Mr. Netting did not consider that he had any reason to doubt the historic quality of the advice which he had given. Moreover, the problem with Mr. Knowles was not the quality of the advice which he had given, but the fact that the advice had been given by three individuals at AMPM rather than by Mr. Knowles.

450. In his oral evidence, Mr. Netting explained that he had not carried out a full historic review because he was satisfied that the AMPM issue was a "contained" issue.

451. Mr. Netting's approach was supported by Mr. Percival. He considered that the actions taken and the speed of action was appropriate. He noted that, following notification, the FSA requested the files for review but did not raise any further concerns about the incident or Sense's handling. He did not consider that it was necessary to have interrogated Mr. Knowles' emails, whether by searching for "high interest deposit scheme" (as suggested by Mr. Morrey) or otherwise. Mr. Percival did not consider that the issues raised were indicative of wider integrity issues at Midas. The issues investigated were not unusual for a firm of Sense's size, and there was support and cooperation from Mr. Greig and the other MFSS directors for the investigation that was carried out: this was a positive indication to Mr. Netting that MFSS wanted to get things right. He described Sense's approach as proportionate and appropriate.

452. The Claimants relied upon Mr. Morrey's evidence that more should have been done. Sense relied upon the evidence of Mr. Netting and Mr. Percival that there had been a proper and reasonable response to the problem. Sense had identified the issue and carried out a review which was designed to, and did, capture all similar cases. Those cases were then investigated and redress paid to clients. Sense also disputed the proposition that it was at fault for not deciding to interrogate Mr. Knowles's emails. But even if those emails had been examined in some manner, they submitted that it could not be said that, on the balance of probabilities, the scheme would have been detected.

Analysis and conclusions

453. I do not consider that the approach taken by Mr. Netting to the problems raised by Mr. Knowles can properly be faulted. Mr. Percival, drawing upon his past experience as an FCA supervisor, said that the steps taken were reasonable and proportionate. This evidence is consistent with the fact that, at the time, the FSA had requested the files for review and did not raise any further concerns about the incident or Sense's handling of it. It is also consistent with the fact that Mr. Netting (and indeed MFSS itself) was very keen to act swiftly and properly in relation to this incident: it cannot be suggested, here, that Mr. Netting was in any way casual. He formed a judgment as to what was necessary, and ascertained that it was a problem that was "contained". I do not believe that his judgment can or should be faulted.

454. By contrast, I consider that Mr. Morrey's views on this issue were extreme, and that the view expressed by Mr. Percival was more balanced. Mr. Morrey's opinion, in my view, owed much to the wisdom of the hindsight knowledge that there was a scheme, and that one of Mr. Knowles' clients (Mr. Lucas) participated in the scheme. The extremity of Mr. Morrey's views on this issue is illustrated by the joint report, where Mr. Morrey criticised the investigation of both Mr. Knowles and another adviser, Ian Towe; and said that in both cases there should have been a much wider review. However, the case in relation to Mr. Towe had, by the end of the case, evaporated. Notwithstanding the views expressed in the joint report, Mr. Morrey accepted that the appropriate action in relation to Mr. Towe would have been simply to sit him down and be more careful in terms of entering situations where there was an apparent conflict of interest, rather than a full-scale investigation of everything that he had written. Mr. Morrey also accepted that the episode with Mr. Towe (which revolved around taking a table at a charitable event being run by a client) did not go anywhere in terms of revealing the scheme. It also seemed to me to be an extreme view to suggest, as Mr. Morrey did in cross-examination, that Sense should have reviewed every client related email that had been sent by or to Mr. Knowles.

455. Since I consider that Sense's response to the Knowles problem was appropriate, it is not necessary to consider what would have happened if, for example, a limited email search had been carried out. However, given that Mr. Knowles had 135 clients, of whom only 1 (Mr. Lucas) had money deposited in the scheme, it is highly improbable that the scheme would have been detected by a sample e-mail search.

456. In their closing argument, the Claimants also suggested, albeit briefly, that Sense should have carried out a similar investigation (to that proposed for Mr. Knowles) in relation to Kevin Alexander, who was also dismissed but for a different problem. However, in the joint report, Mr. Morrey accepted that the investigation into Kevin Alexander, involving a past businesss review of his pensions switching advice, appeared to have been carried out properly. Mr. Percival agreed. I therefore reject any case that Sense is to be criticised in that respect.

N: Causation and Contributory Negligence

457. For the above reasons I have concluded that none of the Claimants' routes to liability succeed. However, in case that conclusion is erroneous, I shall set out my conclusions in relation to the issues of causation and contributory negligence.

458. I have already addressed certain aspects of causation in the context of the claims for breach of the Sense's supervisory obligations addressed in Sections L and M above. If, however, the Claimants had succeeded in relation to their other routes to liability, then it did not seem to me that causation presented any difficulties to the Claimants; for example in the event that the claim based on attribution of Mr. Ingram's knowledge were to succeed. In relation to contributory negligence, however, the arguments were more detailed.

Sense's submissions

459. Sense contended that any damages should be reduced because of contributory negligence. They accepted that this is unusual in the context of a claim by a retail investor against a financial adviser, but they contended that this was an unusual case. There were so many indications to the claimants, or to any reasonable person in their position, that there was something wrong with the scheme.

460. Sense contended that, on any view, a decision by any individual to deposit money in this scheme was extraordinary. All the Claimants deposited significant funds, which they could ill-afford to lose, in circumstances where:

   a. They had received no contractual documentation;
   b. They had received no other documentation relating to the scheme, such as a brochure or other descriptive document;
   c. They were being promised ("guaranteed") rates of return which they must have known (and, in some cases, admit to having known) were far in excess of market rates/Bank of England rate (and, in some cases, rates of interest that they were either being charged for borrowing or were obtaining in other products);
   d. They allege that they relied on the possibility of compensation from RBS and/or the FSCS, when they had not a single sheet of paper confirming that such possibilities existed;
   e. (in the case of investors who "rolled over") they had received no statement of their "account" with the scheme – this being the most basic type of document imaginable.

461. These features of the scheme made it blatant that the offering was too good to be true.

462. Furthermore, any sensible adult knows or ought to know that financial products are accompanied by formal documentation, which in this case was almost entirely absent. Indeed, the single scrap of paper obtained by Claimants in respect of most (but not all) of their deposits raised further questions because of the "execution only" wording – which they accept was either flatly untrue or at least inconsistent with their dealings in relation to the scheme. Thus, the single document provided to them ought to have increased, not reduced, their suspicions.

463. The fact that business in Aberdeenshire is done on the basis of trust and personal connection may explain why they were duped into doing so, but it is not an answer to the charge that they acted unreasonably, judged by any sensible standard. The Claimants themselves were the main authors of their losses. Put shortly, they failed to use their common sense.

464. Those persons who had done other business with MFSS (and therefore had an expectation as to how that business was to be done, what documentation would be supplied, and able to see how different the scheme was) are the more culpable – because they failed to appreciate the significance of the radically different process being followed in relation to this deposit. The lead Claimants in this category were Mr MacKenzie, Mrs. Baylis and Mr. Lucas.

465. So also the Claimants who had some business experience, and/or experience in the financial services industry, are more culpable because it was easier for them to see that the scheme was dubious (to put it no higher). The lead Claimants in this category are Mr Lee; Mr MacKenzie; Mrs Liddell; Mr Creighton; Mr Ansell; Mr Lee; and (by virtue of his police career culminating in the rank of Inspector) Mr Ross.

466. A further aspect of contributory negligence affects those Claimants who claim to have relied on the existence of the FSCS compensation scheme and yet (inexplicably) invested above that limit. This applied to Mr MacKenzie and Mr Ross.

467. A number of Claimants accepted that (in hindsight) their actions had been careless and indeed reckless. Claimants in this category are: Mr Lee; Mr Ross; Mrs Liddell; Mr Creighton. Sense did not suggest that those Claimants who were candid enough to accept this should suffer a greater deduction than those who denied the idea. Sense did submit, however, that their frankness on this point casts light on the credibility of the evidence of those who denied the suggestion.

The Claimants' submissions

468. The Claimants submitted that, in respect of mis-selling and supervisory claims, it was difficult to see how the individuals had contributed to their losses, as opposed to actions or omissions of the regulated firm. They submitted that Sense needed to show a causal connection between any negligence on the claimants' part and the loss that results.

469. The Claimants referred to *Jackson & Powell on Professional Liability* (8th edn, 2017), para 5-172 in support of the proposition that successful pleas of contributory negligence are rare in the professional context, as the parties do not stand on an equal footing. Similarly, in the specific context of financial practitioners, the editors suggest that in a retail investment context the successful invocation of the defence should be "relatively rare": para 15-096. Reliance was also placed on *Rubenstein v HSBC Bank plc* [2005] EWHC 1137 (QB), revsd on other grounds [2012 EWCA Civ 1184, para [128], where the judge refused to reduce damages for contributory negligence. He distinguished cases where a client had ignored advice from professionals, and a deduction for contributory negligence was made.

470. The Claimants submitted that placing one's trust in a qualified and legitimate financial adviser is not negligence: it is reliance. None of them came anywhere near to being

negligent. What they did was to place their faith in somebody they believed to be a qualified and competent and honest financial adviser.

Analysis and conclusions

471. The starting point for consideration of this issue is the Law Reform (Contributory Negligence) Act 1945 s1 (1). This provides that where a person suffers damage

> "as a result partly of his own fault and partly of the fault of any other person or persons … the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage."

472. Contrary to the Claimants' submissions, I do not consider that there is any difficulty in principle, in terms of causation, in reaching a conclusion that the Claimants' losses were in part caused by their own fault, and in part by the fault of Sense.

473. However, in considering the respective causative impact it is necessary to recognise that if Sense had been liable to the Claimants, the reason would be that, for one reason or another, Sense or those for whom it was responsible were at fault. Thus, in relation to most of the causes of action relied upon, the liability would arise because that the scheme was improperly advised upon and promoted by MFSS's professional financial advisers. If the claim were to have succeeded on the basis of attribution of Mr. Ingram's knowledge to Sense, the liability would arise because of a breach by Sense of its supervisory duties for the 7 years that the scheme was operating. If the Claimants had succeeded on their claims of improper monitoring and supervision (see Sections L and M above), then there would by definition have been a breach of the important supervisory duties imposed, for the protection of investors, on Sense.

474. Against that background, if liability had been established, Sense would have had to bear very substantial responsibility for the damage which the Claimants have suffered. The MFSS advisers were market professionals who were recommending the scheme to their clients. And Sense was the market professional with supervisory responsibilities. Sense's argument on contributory negligence that the Claimants themselves bear some responsibility for their losses must be seen in that context.

475. I also agree with the Claimants that it is important to recognise that this is a case where they trusted the advisers who were giving the advice. I have already described (Section E above) the way in which the scheme was sold to the investors. In many cases, there was a long-standing client relationship or personal relationship between the advisers and the lead claimants, or members of their family. A successful financial adviser will, for perfectly legitimate reasons, seek to build up and develop the trust and confidence of his retail clients, and this is what happened in this case. Again, this is an important factor which is relevant to the question of whether a reduction should be made in the present case. No doubt this is one reason why, according to *Jackson & Powell*, the

successful invocation of a contributory negligence defence in relation to claims by claimants in a retail investment context is "likely to be relatively rare".

476. It is also important that Sense's criticisms of the Claimants, as summarised above, should be seen in the context of what appeared at the time to be the positive aspects of the scheme. Many of the Lead Claimants knew people who had invested in the scheme successfully, and had done so for a number of years. Nearly all the Lead Claimants themselves appeared to be enjoying some success with the scheme, in that they were paid or credited with interest and, at least up until August 2014, were able to take out their money if they wanted to.

477. I also regard it as a positive point in favour of the Lead Claimants on contributory negligence, rather than a negative point against them, that the Lead Claimants comprised, by and large, intelligent people who in many cases had enjoyed success in their careers including in business and in the financial services industry. The fact that a group of intelligent people invested in the scheme seems to me to demonstrate that it appeared plausible and legitimate, and that they received what appeared to be good answers to the questions that were asked.

478. It is also important to bear in mind that each of Lead Claimants described a personal meeting with an MFSS adviser, where the scheme was persuasively sold to that individual. The trial has heard evidence from a large group of claimants, and this might give the impression that there was here a collective failure. But they were not acting as a group at the time.

479. Against this background, I do not consider that the points raised by Sense provide reasons for making any reduction on the grounds of contributory negligence.

480. I agree that there was an absence of documentation, but each of the claimants did receive confirmatory letters which contained the relevant promise. As time went by, some payments were received unless the decision was made to roll over the amounts due in their entirety. They also received verbal explanations from individuals that they trusted as to how things would work, including for example the involvement of RBS and potential compensation under the FSCS. Just as in *Rubenstein,* I do not think that it is right to treat the Claimants as being at fault because they did not probe further or challenge the advice received.

481. I agree that the rates of return were well in excess of Bank of England base rate or rates obtainable on the high street. However, I do not see why this should be regarded as a reason for saying that the Claimants were at fault in investing in the scheme, particularly in circumstances where they understood that other people had successfully done so, where the scheme was being sold positively by a financial adviser, and where explanations were provided to those who asked. It is particularly striking that Mr. Cutler, who worked for MFSS, was willing to invest substantial sums.

482. As Sense pointed out, some Lead Claimants were willing to describe, with the benefit of hindsight, their actions as being negligent or even reckless. But this is with the benefit of hindsight. Furthermore, it is not surprising that some Claimants, who have of course lost very substantial sums as a result of this scheme, have a tendency with the benefit of hindsight to be self-critical for what they did.

483. In these circumstances, I do not consider that it can properly be said that the Claimants' losses were suffered partly as a result of their own fault. But in any event, even if this were too generous to the Claimants, I do not think that any reduction for contributory negligence would be appropriate, particularly bearing in mind the responsibility of Sense as described above.

O: Quantum Issues

484. In view of my conclusions that the Claimants fail on their routes to liability, the issues of quantum do not arise. Nevertheless, I consider it appropriate to make findings, to the extent that I can, as to the losses which each of the Lead Claimants has suffered.

485. By the end of the hearing, it was common ground that the Claimants' losses were to be calculated on a "no transaction" basis. The Claimants therefore calculated these losses by reference to the money invested into the scheme less the money received out of the scheme, together with interest. Sense accepted that a rate of interest should be applied to the money invested in the scheme, but there were disputes (which I will not resolve in this judgment) as to the applicable rate of interest and to some extent the period over which interest was to be calculated.

486. There was agreement between the parties, in relation to 7 Lead Claimants, as to the difference between the amounts invested and the amounts received, namely:

Lead Claimant	Deposits (£)	Withdrawals (£)	Difference (£)
Mr. and Mrs. Hutchinson	246,500	155,015	93,485
Mr. Masson	39,685	7,937.50	31,747.50
Mr. and Mrs. Creighton	135,000	2,400	132,600
Mr. Rognaldsen	130,000	-	130,000
Mr. MacKenzie	155,000	1,355.51	153,644.49
Mr. and Mrs. Ansell	190,143	106,913.20	83,229.80
Mr. and Mrs. Ross	286,300	59,174	227,152

487. In relation to the other 5 Lead Claimants, however, there were disputes. The detail of the disputes emerged subsequent to the hearing after the parties had sought to agree

quantum. I was provided with a letter from Sense's solicitors dated 2 August 2018, a response from the Claimants' solicitors dated 21 August 2018, and a written submission on quantum from Sense's counsel.

488. *Mr. Lucas*. The Claimants contended that Mr. Lucas had invested £ 72,941.06 in the scheme, and withdrawn only £ 6.93, resulting in a difference of £ 72,934.13. This calculation focused on the investments made by Mr. Lucas after March 2012. Sense contended that the amount invested was substantially greater (£ 188,690.44), and that the withdrawals were £ 127,111.75, resulting in a difference of £ 61,578.69. The reason for these higher figures, and the lower difference, was that Sense took into account all of Mr. Lucas's deposits from 2008 onwards. This was important, because Mr. Lucas was repaid the earlier investments, including the beneficial rate of interest resulting in what Sense properly described as a "profit" to Mr. Lucas. Sense contended in their closing submissions, and in their post-hearing submissions, that this profit should be taken into account; specifically a profit of £ 18,868.12 arising on a withdrawal in November 2011. The Claimants argued that there was no legal requirement for such credit to be given.

489. I accept Sense's submission on this issue. It is right to look at Mr. Lucas' investment in the scheme as a whole. If he received profits as a result of his investment in the scheme, then those should be brought into account. The relevant test in this connection is that of Sir Andrew Morritt VC in *Needler Financial Services v Taber* [2002] 3 All ER 501, approved in *Rubinstein v HSBC Bank PLC* [2012] EWCA Civ 1184, para [135]:

> "In my view the authorities to which I have referred establish two relevant propositions. First, the relevant question is whether the negligence which caused the loss also caused the profit in the sense that the latter was part of a continuous transaction of which the former was the inception. Second, that question is primarily one of fact".

490. In the present case, I agree with Sense that all the deposits and withdrawals form a "continuous transaction" in the necessary sense. All the monies were placed in the same scheme. The deposits were all attributable to the same defaults of which complaint is made in the action. The profits made by Mr. Lucas were not attributable to some decision, or event, which was extraneous to the scheme. The fact that there was a short period between the maturity of one deposit in November 2011, and Mr. Lucas' decision to make a further deposit in March 2012, does not affect the conclusion that this was a continuous transaction.

491. A similar issue arose in relation to Mr. and Mrs. Baylis where, on Sense's case, Mr. and Mrs. Baylis had not lost any money. Looking at the period from 2004 to 2014, the deposits were £ 121,575 and the withdrawals were £ 133,088.32. The relevant profits were made on maturities in June and July 2009, whereas the Claimants' loss calculation started in December 2009 and omitted these maturities. Again, I conclude that all the deposits and withdrawals formed part of a "continuous transaction", notwithstanding the short period of time between June and July 2009 and December 2009.

492. It was not clear to me whether the Claimants accepted that Sense's figures were correct if (as I have held) the profits should be taken into account. It appeared from the Claimants' post-hearing letter of 21 August 2018 that this may have accepted as far as

Mr. Lucas was concerned. Had the Claimants succeeded on liability, I would have sought clarification on that issue before reaching a final determination.

493. *Mr. Lee*. The Claimants contend that Mr. Lee's losses (amounts invested less amounts withdrawn) were £ 164,027. Sense contended that the correct figure is £ 140,140.75. There is no dispute that the amounts invested were £ 190,277. The dispute concerned the amounts withdrawn: the Claimants contending for £ 26,250, and Sense contending for £ 50,116.

494. In their letter dated 2 August 2018, Sense's solicitors requested the Claimants to comment on the various detailed "Loss Schedules" which had been produced as part of their closing submissions, and had specifically drawn attention to the position in relation to Mr. Lee, where Sense alleged that the Claimants had not taken into account various withdrawals. The Claimants declined to do so in relation to Mr. Lee, relying upon the fact that Mr. Lee had not been challenged during cross-examination on either (i) the figures which he had produced in a schedule referred to in his statement or (ii) the additional withdrawals relied upon by Sense in the loss schedule produced as part of its closing submissions.

495. I consider that the position on the Claimants' evidence relating to Mr. Lee's figures is not satisfactory. The schedule of loss referred to by Mr. Lee in his evidence gives a figure for withdrawals of £ 30,250. It is not clear to me why the Claimants now contend that the withdrawals were £ 26,250: they appear to have omitted a withdrawal of £ 4,000 which Mr. Lee accepts was made. In addition, the schedule of loss omits a withdrawal of £ 2,500 in June 2013 which Mr. Lee, in paragraph 46 of his witness statement, admits was paid. That withdrawal is also evidenced by an encashed cheque contained in the trial bundles, and the bank statement of the scheme account. A further encashed cheque in the trial bundles, for a smaller amount of £ 68.75, is also omitted from the Claimants' schedule (and indeed Mr. Lee's evidence was that he "did not believe" it was paid. Again, however, the cheque in the trial bundles is also evidenced by payment out of the scheme bank account.

496. Sense's loss schedule also includes a number of other payments which can be identified as having been made from the scheme bank account, and which are said to have been paid to Mr. Lee. The bank statements do indeed evidence the payments, but it is not clear why Sense contends (in the absence of the cheques) that these payments were made to Mr. Lee. Mr. Lee was not asked about any of these other withdrawals in evidence.

497. Against this background, and in particular the discrepancies in the Claimants' figures to which I have referred, I would not have been inclined (had the issue arisen) to award Mr. Lee the figures set out in his schedule. I would have directed Mr. Lee to review Sense's loss schedule (as Sense had invited the Claimants to do). I would also have asked Sense to identify the documents within the trial bundle showing how the payments from the scheme account, and where there is no encashed cheque, can be related to Mr. Lee. I therefore come to no final conclusions as to Mr. Lee's loss, save that it seems to me that the withdrawals were at minimum £ 30,250 plus £ 2,500 plus £ 68.75 = £ 32,818.75.

498. *Mrs. Shepherd*. The Claimants contend that Mrs. Shepherd's losses are £ 119,200 comprising deposits in that amount, without credit for any withdrawals. Sense contend

that the correct figure is £ 98,033 less an allowance of £ 744.21 for "profits" made from the scheme on a deposit in 2007. The parties' submissions identified two issues between them.

499. The first issue concerns the inclusion of a payment of £ 8,000 in February 2011. I agree with Sense that this figure should be excluded, because the scheme bank account clearly shows that the relevant cheque from Mrs. Shepherd was unpaid.

500. The second issue concerns a number of withdrawals shown in a handwritten document, prepared by Kevin Alexander, and which was disclosed by the Procurator Fiscal. The entries showed deposits and repayments in 2007 and 2008. In her evidence, Mrs. Shepherd's recollection was that she had not invested in the scheme until 2009. Mrs. Shepherd suggested, somewhat tentatively, that some of these entries might relate to a property bond investment made with Mr. Alexander. However, she went on to say that she was "unsure" about whether she had invested in 2007, and that it "appears so" that she invested from 2007 onwards.

501. Since Mr. Alexander's document as a whole clearly relates to the scheme, and since there is no documentary evidence of a property bond to which the entries might refer, I agree with Sense that these entries relate to the scheme. Credit must therefore be given for the withdrawals and any profits made.

502. It was not clear to me whether these two issues comprised the entire difference between the parties on the figures concerning Mrs. Shepherd. Had the Claimants succeeded on liability, I would have asked for further assistance from the parties on the final figures.

503. *Mrs. Liddell*. In her statement, Mrs. Liddell said that she was unable to quantify her losses without full disclosure from the Bank of Scotland and/or RBS and/or the help of a forensic accountant. However, she said that here losses were at least £ 309,825. This was quantified by reference to various acknowledgment letters dated between 10 September 2012 and 28 July 2014, all of which had maturity dates after 7 August 2014.

504. Mrs. Liddell also said in her statement that she did not believe that she had received any money out of the scheme, although she modified this in her oral evidence: she said that she took interest on the odd occasion, but only small figures.

505. In their written closing submissions, the Claimants contended that Mrs. Liddell had invested £ 271,500 in the scheme (i.e. a figure lower than that contained in Mrs. Liddell's statement). It was not clear to me how this figure of £ 271,500 was calculated. The post-hearing quantum correspondence also referred to a schedule relied upon by the Claimants in relation to Mrs. Liddell, but it was also not clear to me what schedule was relied upon. In that correspondence, the Claimants accepted that there were "acknowledged difficulties with Mrs. Liddell's early investments". Various figures were referred to, and it was contended that various credits claimed were "all justified by bank statements". However, the letter contained no references to where those bank statements were contained in the hearing bundles, or indeed to what the credits actually were.

506. The Claimants did, however, accept that there had been a number of withdrawals, amounting to £ 27,615. The claim, at least as advanced in the Claimants' written closing was therefore £ 243,885; being £ 271,500 less these credits.

507. Sense contended that the lack of disclosure provided by Mrs. Liddell rendered a full calculation impossible. However, Sense accepted that the documents showed that she had deposited £ 240,750. But this figure was not comparable to the figure of £ 309,825 in Mrs. Liddell's statement. The £ 240,750 referred to deposits made in 2002 and 2003, whereas the £ 309,825 referred to acknowledgment letters which were much later in time. Sense alleged that she had withdrawn £ 173,405, leaving a net balance of £ 67,345.

508. Against this confused background, if it had been necessary to make findings as to Mrs. Liddell's losses, I would have asked the parties, and in particular the Claimants, for some further assistance as to the figures being relied upon and what the documentary support for those figures was.

509. I would, however, have been unwilling to accept Mrs. Liddell's oral evidence as to what the figures were, at least without appropriate and comprehensible documentary support. This is because I did not regard Mrs. Liddell as a reliable witness in relation to the amounts invested and withdrawn. Mrs. Liddell's evidence that she only received small sums of interest from the scheme was, clearly, not accurate. For example, a cheque for £ 20,400 was received and endorsed by her, and in evidence she accepted that this money had been received. She could not recall what she did with the money, but assumed that she reinvested it. But it is clear that the money was received, and thus withdrawn for a period of time. Another cheque was in the sum of £ 15,000, and this was not a small sum of interest. There was also documentary evidence which indicated, contrary to Mrs. Liddell's evidence, that some £ 64,201 had been paid to her, albeit that she may possibly subsequently have reinvested it.

510. The only other finding in relation to Mrs. Liddell which I can make at this stage concerns the question of whether she gifted £ 50,000 or £ 60,000 to her daughter. On the basis of a letter dated 2 June 2004, and Mrs. Liddell's evidence in cross-examination, the appropriate figure is £ 60,000.

P: Conclusion

511. Since I have concluded that none of the routes to liability succeed, the claims of the Lead Claimants are dismissed.