FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2018] CSIH 9
CA118/16

Lord President
Lord Drummond Young
Lord Malcolm

OPINION OF THE COURT

delivered by LORD CARLOWAY, the LORD PRESIDENT

in the reclaiming motion by

MARINE & OFFSHORE (SCOTLAND) LIMITED

Pursuers and Reclaimers

against

(SECOND) GARY ROBERT HILL; and (THIRD) MCA INSPECTION SERVICES LTD

Defenders and Respondents

Pursuers and Reclaimers: McIlvride QC; Harper Macleod LLP
(Second and Third) Defenders and Respondents: DM Thomson QC; Beveridge & Kellas

7 February 2018

Introduction

[1] This is a reclaiming motion against an interlocutor dated 4 July 2017 in which the commercial judge sustained the second and third defenders' pleas to the relevancy of the pursuers' averments and dismissed the action in so far as directed against them. The issue concerns the level of specification required in a commercial action which avers fraud and resultant loss.

Averments

[2] The pursuers are contractors who provide maintenance services to the oil and gas industry. At the material time, the first defender was an employee of the pursuers. The second defender was an employee of Talisman Sinospek Energy UK Ltd (Talisman), who contracted with the pursuers for the supply of fire protection inspectors and related services. The third defenders are a company of which the second defender and his wife were the sole shareholders. The pleadings of both parties might be described as voluminous. For what is a relatively simple set of facts, they run to 34 closely line spaced pages.

[3] The averments incorporate much peripheral detail and often plead supporting evidence rather than relevant fact. In an intricate passage, which appears to be an attempt to say no more than that the first and second defenders negotiated the relevant contract between the pursuers and Talisman, it is said that:

> "... the pursuers provided ... fire protection services to Talisman. The employee of the pursuers who secured the orders for those services from Talisman was the first defender. The employee of Talisman who was responsible for selecting the supplier of those services was the second defender. The first and second defenders had been involved in discussions regarding the placing of orders by Talisman with the pursuers before any orders were placed. It is believed and averred the matters discussed included the prices which the pursuers proposed to charge and Talisman was willing to pay."

[4] The pursuers did not employ the fire inspectors. Rather, the first defender arranged for ("procured") the inspectors, one of whom was his wife, to be employed by the third defenders. The pursuers then contracted with the third defenders to supply them to Talisman. The pursuers fulfilled Talisman's orders for inspectors at "fixed prices" for labour. Under reference to timesheets submitted by the pursuers, in support of invoices rendered to Talisman, it is "believed and averred" that the second defender knew that the rates charged were "fixed rates agreed between them" (ie the pursuers and Talisman).

These rates were £625 and £725 plus VAT per day for, respectively, onshore and offshore work. The relative market rates were only £275 and £400. Again using the formula "believed and averred", and under reference to averments about their experience in the industry, it is said that the first and second defenders were "familiar with the prevailing market rates". A total of £777,175 plus VAT was paid for services worth £368,525 on the open market.

[5] The pursuers aver in detail the content of a series of emails between the first and second defenders which they then incorporate *brevitatis causa*. They refer to cash payments amounting to several thousand pounds made by the third defenders to the pursuers before "believing and averring" that part of the inflated sums paid by the pursuers to the third defenders were in turn paid to the first defender. There is a general averment that all of the defenders knew that the prices charged by the third defenders to the pursuers were materially greater than the salary costs, had the pursuers themselves employed the inspectors or had the services been obtained in the open market.

[6] Rather than aver simply that the defenders defrauded the pursuers by agreeing to overcharge for the time of the inspectors, the pursuers aver first, what might, at first glance, be thought to be a case of negligence by stating that the second and third defenders had a "duty" not to enter into a fraudulent scheme designed to cause loss to the pursuers. Secondly, they plead a case of inducing a breach of the first defender's contract of employment with the pursuers; this involving the payment by the pursuers to the third defenders of excessive sums.

[7] The damages claim is phrased as one for a loss of profit, which, it is said, the pursuers would have made, if the pursuers had obtained the services of the inspectors at the market rate. It is expressly stated, indeed repeated, that:

> "In accordance with the orders placed by Talisman and accepted by the pursuers the invoices rendered ... include charges for the services of the inspectors at fixed rates ... Had the pursuers not placed orders with the third defenders for the agency labour services they would have obtained the benefit of these services as agency labour on the open market at a price of around £368,525 excluding VAT ... [T]he loss of profit ... amounts to £408,650" (ie £777,175 – 368,525).

[8] The case against the first defender is based on a breach of the terms of his employment with the pursuers. It is agreed that this case is suitable for inquiry, although a proof before answer has not yet been allowed. The first defender was not involved in the reclaiming motion.

The commercial judge's reasoning

[9] The commercial judge determined that the averments of a fraudulent scheme were irrelevant. There were no averments that the second and third defenders had intended to deceive or about the means by which they participated in the scheme. Only if they had known that the pursuers' charges to Talisman had been "fixed" would they have known that the pursuers would sustain a loss. The pursuers had not averred that the first or second defenders had set the rates for the Talisman contract. They had not averred that the second defender had been aware of the rate, or that it was a fixed one which would result in the pursuers suffering a loss of profit if they (the pursuers) were charged an excessive rate by the third defenders. Being involved in contractual discussions was not enough and that fact did not merit the inference that they were aware of the price. The pursuers had to aver that the rate charged to Talisman would have remained as it was, irrespective of that charged by the third defenders. As secondary points, there were insufficient averments that the pursuers (ie the officers of the company) had been deceived. There was no averment that

the second and third defenders knew of the extent of the pursuers' delegated authority and what he was, or was not, telling his superiors. Overcharging did not amount to fraud.

[10] The averments of loss were also irrelevant. There was no averment that the rate which the pursuers charged Talisman would have been the same regardless of what the pursuers required to pay the third defenders (ie in a "fraud-free" world). The pursuers would be unable to establish that there would have been a loss of profits if the third defenders had charged less. The defenders had averred that the pursuers' contract with Talisman had been on a cost plus 10% basis. This detailed counter position, that there had been no fixed rates, required to be answered (*Gordon* v *Davidson* (1864) 2 M 758 at 768) by the pursuers stating when and how any fixed rates, or a mechanism for fixing them, had been agreed. The pursuers' bald averment lacked any specification. Calls for such specification had remained unanswered and this had to be understood as an implied admission (*Albyn Housing Society* v *Active Air Conditioning* [2016] CSOH 110).

Submissions

Pursuers

[11] The pursuers accepted that a general averment of fraud would not suffice (*Royal Bank of Scotland* v *Holmes* 1999 SLT 563). The pretence here was that the pursuers, Talisman and the third defenders were entering into a normal commercial arrangement in circumstances in which the defenders had arranged for the pursuers to pay charges at double the market rate. The pretence was that the price was commercially acceptable. The test of relevancy was whether the pursuers' averments, looked at on their own, were capable of yielding an inference of fraud (*McMullen Group Holdings* v *Harwood* [2011] CSOH 132 at para [77]); whether the averments of primary fact were capable of supporting that inference

(*Burnett* v *Menzies Dougal* 2006 SC 93 at paras [16]-[17]). A denial was not to be taken as an admission (*Gray* v *Boyd* 1996 SLT 60 at 63 and 65). A failure to answer calls did not render pleadings irrelevant (*Bonnor* v *Balfour Kilpatrick* 1974 SC 223 at 227). Where a great deal might turn on inference or nuance, the court should be slow to dismiss a case (*Heather Capital* v *Levy & McRae* 2017 SLT 376 at para [100]).

[12] The pursuers maintained that, once the first and second defenders had fixed the rate to be paid by Talisman, their actions in fixing the level of payment to the third defenders at above the market rate had caused a loss of profit. The rates agreed by Talisman were relevant only to establish the profit margin which would have been available had the pursuers paid normal market rates. The pursuers offered to prove that the defenders had been aware of the rate to be paid by Talisman and had, in that knowledge, procured that the pursuers paid to the third defenders a rate considerably in excess of the market rate with a view to sharing the inflated element. The first and second defenders had been involved in the discussions regarding the orders placed by Talisman with the pursuers. The averments were capable of supporting the inference that this would have included the prices to be charged. The pursuers offered to prove that the first defender had been responsible for procuring the contract. The pursuers did not require to prove how the rates had been set.

[13] On *quantum*, the pursuers offered to prove that the rates had been fixed. They offered to prove that they had suffered loss as a result of the defenders procuring that the pursuers pay the third defenders at rates materially greater than those prevailing in the market, thus depriving the pursuers of a substantial element of the profit which they would otherwise have made. What was relevant was whether Talisman had agreed fixed rates with the pursuers and what the pursuers' profit would have been had they been paying at the normal market rate. The judge had erred in holding that the pursuers had to be deemed

to have admitted the defenders' averments that the rate was one of cost plus 10%. The pursuers had denied that.

Defenders

[14] The defenders maintained that the averments were irrelevant. The pursuers' ground of action, as stated in their first plea-in-law, was that the defenders had acted "in concert" in devising and executing a fraudulent scheme which was intended to cause loss to the pursuers. Any search, to find averments of what that scheme had been, would be in vain, despite the many opportunities, by way of amendment and otherwise, that the pursuers had been afforded to plead a relevant case. The pursuers had made no averments of conscious dishonesty. They did not aver that, but for the alleged fraud, the contract between the pursuers and Talisman would have been entered into on the same basis as in fact occurred. The pursuers' failure to respond to the detailed averments, that the agreement had been cost plus 10%, entitled the commercial judge to proceed on the basis that the defenders' averments were well-founded. The pursuers did not offer to prove that they had been unaware of the sums which they were paying to the third defenders or that they were deceived, far less that they had been deceived by anything done by the defenders. They made no averments that anything done by the first defender had been known to the second and third defenders.

[15] The pursuers required to make clear and specific averments to support the proposition that, in the absence of the fraud, the rates charged by the pursuers to Talisman would have been the same as were in fact charged. All that they had averred was that, had the pursuers obtained the services at the prevailing market rates, their profit would have increased by the sum sued for. They made no averments about the way in which they came

to enter into the contract with Talisman, or the way in which the rates had been agreed. The averment that the rates were "fixed" was simply a statement that definite sums were to be paid. The pursuers appeared to be saying that they wished to recover the proceeds of a fraud in circumstances where these proceeds had been derived from a deception played on Talisman. The conclusion, that their averments of loss were irrelevant, was reinforced by their failure to make a proper and adequate response to the averments made by the defenders to the effect that the rates agreed with Talisman had simply been cost plus 10%. That had been met by a general denial. Calls had been made to explain how the rates had been charged, but these had remained unanswered.

Decision

[16] This is a commercial action in which the requirements in a summons are that the circumstances out of which the action arises should be "summarised" (RCS 47.3(2)(c)). The rules applicable to averments in an ordinary action do not normally apply with the same rigour. Lengthy narrative is to be avoided. However, it has been said that, where fraud is alleged, fair notice requires relevancy of the same standard as in such an action (*Kaur* v *Singh* 1998 SC 233, Lord Hamilton at 237). It is not difficult to understand what has to be averred. Fraud is a "machination or contrivance to deceive" (Erskine: *Institute* III.1.16). There requires to be a false pretence and, in the civil context, resultant loss (a practical result). It follows that there must be clear and specific averments of the representation founded upon and how the loss was sustained. General allegations will not suffice (*Shedden* v *Patrick* (1852) 14 D 721, Lord Fullerton at 727; *Royal Bank of Scotland* v *Holmes* 1999 SLT 563, Lord Macfadyen at 569, following *RH Thomson & Co* v *Pattison, Elder & Co* (1895) 22 R 432).

[17] Despite the lengthy narrative provided by the pursuers, which serves largely to obscure rather than clarify the facts, it is possible to extract from the averments a relatively straightforward case in which the pursuers offer to prove that the defenders entered into a fraudulent scheme to defraud them of money, by inflating the prices of inspectors, which were charged to them. The pleader may have confused the circumstances in which the formula "believed and averred" can, and in rare cases ought, to be used. There is a significant difference between a situation in which a party can only prove certain facts, but an inference can be drawn from those facts (where the formula may be used) and one where the party has circumstantial evidence from which fraud is, by inference, proved. In the latter, a straightforward averment is appropriate.

[18] It is nevertheless sufficiently clear, once the narrative mist has been dispersed, that the pursuers are averring that the first and second defenders were the persons who negotiated the contracts between the pursuers and Talisman and between the pursuers and the third defenders. Each defender was aware that the rates charged were deliberately and excessively inflated in a manner which was designed to produce gain for each defender. The pretence to the pursuers, which was achieved because the first defender was in control of the contracts and concealed their true nature from others in the company, was that these were ordinary commercial transactions in which the pursuers were paying acceptable rates; the truth being that the rates were inflated. The practical result was that the pursuers paid to the third defenders unnecessarily large amounts of money. The bulk of what would otherwise (see *infra*) have been profit to the pursuers was syphoned off into the hands of the defenders; the latter element providing sufficient evidence from which a dishonest intention could readily be proved. There are then sufficient averments of a fraudulent scheme to

deprive the pursuers of funds with the intention that each defender make an illegitimate profit.

[19] There is considerable force in the defenders' argument that the averments of loss are of an almost skeletal nature. They do, on the other hand, have the admirable quality of simplicity. In that context, it is not entirely clear why it is thought necessary to involve the Talisman contract in the calculation of loss. It might have been more simply expressed as being the difference between the sums which the pursuers paid to the third defenders for the services of the inspectors and the sums which they would have paid but for the fraudulent scheme. The defenders' contention in this regard is not an attractive one. Stripped of complexity, and while it is not put in those bald terms, it is to the effect that the pursuers did not, on the averments, suffer any loss because the defenders were defrauding Talisman too. It was Talisman who, on the pursuers' account, lost out. That may be, but if Talisman were also defrauded, that would not render the pursuers' case of loss irrelevant. In this regard, the pursuers offer to prove that, whatever the cause of it might have been, they had, through the offices of the first and second defenders, entered into a fixed price contract. They deny the defenders' averments that this was a costs plus 10% contract. That denial cannot be construed as an admission (*Gray* v *Boyd* 1996 SLT 60, LJC (Ross) at 63, disapproving *EFT Finance* v *Hawkins* 1994 SLT 902). The existence of calls seeking further specification do not detract from the pursuers' case either (*Bonnor* v *Balfour Kilpatrick* 1974 SC 223, Lord Ordinary (Kincraig) at 227).

[20] Whether the pursuers succeed in proving their averments is another matter, but it cannot be said that, if they do, they are bound to fail. The court will accordingly recall the interlocutor of the commercial judge, dated 4 July 2017 (except in so far as holding a previous interlocutor *pro non scripto*), and allow a proof before answer between these parties.