# WHOSE INIQUITY IS IT ANYWAY?

*Accident Exchange v McLean*

The recent decision of Sir Andrew Smith in *Accident Exchange Ltd v McLean* ("*Accident Exchange*")[1] has clarified the law relating to the iniquity exception to privilege[2] in two significant ways. First, by establishing that the "innocent tool" test propounded by Lord Goff of Chieveley in *R v Central Criminal Court, ex p Francis & Francis* ("*Francis & Francis*")[3] is to be applied when determining whether an innocent client should lose privilege as a result of iniquity perpetrated by a third party. Second, by providing guidance as to how the "innocent tool" test is to be interpreted in practice.

## Background to the case

The claimants (referred to as "AE" in the judgment) were companies providing "replacement motor vehicles on credit terms to clients whose vehicles have been damaged in road accidents".[4] AE's business involved recovering hire charges from drivers who had caused the accidents ("Defendant Drivers") or their insurers, by means of credit hire claims. Autofocus Ltd ("AF") were the perpetrators of "perjury on an industrial scale"[5] in certain credit hire claims involving AE. As a provider of forensic services, AF fabricated and manipulated evidence about the rates of hire of replacement vehicles. AF's perjured evidence was then used by some Defendant Drivers to "strip out" allegedly irrecoverable credit elements from vehicle hire charges levied by AE, to AE's substantial detriment.[6] AE accordingly brought a claim seeking damages for conspiracy and deceit against certain directors of AF as well as various solicitors who acted for the Defendant Drivers (the "Solicitor Defendants"). Following the exchange of disclosure lists, AE brought an application against the Solicitor Defendants seeking inspection of documents, over which the Solicitor Defendants asserted privilege on behalf of the Defendant Drivers. AE sought to rely on the iniquity exception to defeat this claim for privilege.

*Accident Exchange* also deals with an application by some of the Solicitor Defendants for disclosure of other documents held by solicitors acting for AE's clients. This aspect of the judgment is not considered in this note.

1. [2018] EWHC 23 (Comm); [2018] 4 WLR 26.
2. See generally Bankim Thanki QC, *The Law of Privilege*, 3rd edn (Oxford University Press, Oxford, 2018), [4.37–4.75] ("Thanki"); Colin Passmore, *Privilege*, 3rd edn (Sweet & Maxwell, London, 2013), ch.8 ("Passmore").
3. [1989] AC 346.
4. *Accident Exchange*, [1].
5. *Accident Exchange Ltd v Broom* [2012] EWHC 207 (Admin), [7] (Irwin J, referring to Moses LJ's description during argument on AE's application to pursue contempt proceedings against seven "rates surveyors" working for AF). They were found guilty of contempt of court for fabricating evidence in a "systematic and endemic" fashion (*Accident Exchange Ltd v Broom* [2017] EWHC 1096 (Admin), [322] (Supperstone J).
6. When a replacement vehicle is hired on credit terms following an accident by someone who does not need credit, the costs attributable to the provision of credit will not be recoverable against the negligent driver and/or their insurer: *Dimond v Lovell* [2002] 1 AC 384; *Dickinson v Tesco Plc* [2013] EWCA Civ 36. Only the "Basic Hire Rate" will be recoverable.

## The iniquity exception

AE argued that, as a result of AF's wrongdoing, the iniquity exception applied to prevent the Defendant Drivers' claim for privilege. AE provided uncontested evidence of AF's perjury, which was accepted by Sir Andrew Smith.[7] However, AE did not allege iniquity, dishonesty, and/or impropriety on the part of the Defendant Drivers.[8]

Two key issues therefore arose. First, what test to use when applying the fraud exception to cases where the relevant iniquity was committed by a third party ("third-party cases"). Second, whether the requirements of this test had been made out in relation to the Solicitor Defendants.[9]

Sir Andrew Smith began by reviewing a number of authorities dealing with the iniquity exception in third-party cases. The earliest was *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* ("*Banque Keyser*"),[10] in which the Court of Appeal refused inspection of documents passing between innocent banks and their legal advisors.[11] The reasoning in *Banque Keyser* was highly fact-specific. Parker LJ ruled that there had not been communications "otherwise than in the ordinary course of professional communications" between the banks and their legal advisers.[12] Since the third-party iniquity did not undermine the basis of legal professional privilege in this case, privilege existed in the documents over which inspection had been sought.[13] More broadly, Parker LJ rejected a submission that part of the rationale of the iniquity exception was to allow the court to put itself in a better position to decide the issue of fraud,[14] and further expressed concerns about undermining legal professional privilege to an excessive degree:[15]

> "To do so would involve the consequence that once there was a fraud, the party who was complaining could obtain discovery of documents otherwise covered by professional privilege not only against the fraud himself, but against anybody else who might be in a position to give evidence."

*Banque Keyser* was not construed by Sir Andrew Smith as a categorical rejection of the iniquity exception in third-party cases, in the light of its fact-specific reasoning. In any event, *Banque Keyser* had been superseded by the House of Lords' decision in *Francis & Francis*.[16]

7. *Accident Exchange*, [13].
8. *Ibid*, [19].
9. "This leads to the core issues on this application: whether in cases of wrongdoing by a third party the client loses the protection of privilege only if (s)he is the wrongdoer's innocent tool, and if so whether the clients of the defendant solicitors (whether they be defendant drivers or their insurers) are to be so regarded": *ibid*, [24].
10. [1986] 1 Lloyd's Rep 336.
11. Substantial loans were made by banks with gemstones used as security and insurance policies taken out to cover the banks against failure to repay the loans. Following default, the insurers alleged that the valuations of the gemstones had been fraudulently inflated by the borrowers. Disclosure of documents passing between the banks and their legal advisors was sought in the claim that ensued.
12. *Ibid*, 338 (Parker LJ). It may also be instructive to see *Banque Keyser* as an instance where the banks were victims of—and not participants in—the fraud: Paul Matthews and Hodge Malek, *Disclosure*, 5th edn (Sweet & Maxwell, London, 2017), [11.78]; Hodge Malek, *Phipson on Evidence*, 19th edn (Sweet & Maxwell, London, 2018) ("*Phipson*"), [26.55].
13. See also Passmore, [8.013].
14. *Banque Keyser*, 338 (Parker LJ).
15. *Ibid*, 338 (Parker LJ).
16. Notably, there was no reference to *Banque Keyser* in *Francis & Francis*: Charles Hollander QC, *Documentary Evidence*, 13th edn (Thomson Reuters, London, 2018) ("*Hollander*"), [25.14]; *Phipson*, [26.55].

In *Francis & Francis*, it was alleged that drug traffickers had laundered their proceeds by assisting innocent relatives with property purchases. The police obtained an order for disclosure of documents relating to one of the trafficker's relatives, who was accepted to be innocent. On application for judicial review to quash the said order, and on appeal thereafter, the House of Lords rejected the challenge by a majority of three (Lords Brandon of Oakbrook, Griffiths and Goff) to two (Lords Bridge of Harwich and Oliver of Aylemerton).

Since *Francis & Francis* was a criminal law case, the reasoning of the Law Lords focused heavily on s.10(2) of the Police and Criminal Evidence Act 1984, which governed the issue before them. The relevance of *Francis & Francis* to *Accident Exchange* arises instead from Lord Goff's and Lord Griffith's *obiter* comments on the iniquity exception at common law.[17] In particular, Lord Goff considered—and Lord Griffith concurred—that a client who had been used as an "innocent tool" could lose privilege under the fraud exception:

"[It is] immaterial […] whether it is the client himself, or a third party who is using the client as his innocent tool, who has the criminal intention. In either case, to adopt the words of Stephen J, the communications are intended to further a criminal purpose; in either case, the protection of such communications cannot be otherwise than injurious to the interests of justice; and in either case, the communications are in furtherance of a criminal purpose, and so cannot come within the ordinary scope of professional employment […] the criminal intention of the third party will, in the circumstances under consideration, exclude the application of the principle of legal professional privilege at common law, even though the privilege, if it attached, would be the privilege of the client and not the third party".[18]

"I am convinced that Parliament was not seeking to enact a special code of legal privilege of different import to the common law position. […] I am in entire agreement with the analysis of the language of the section contained in the speech of my noble and learned friend, Lord Goff of Chieveley, and for the reasons that he gives I would construe the words as applying to all documents prepared with the intention of furthering a criminal purpose whether the purpose be that of the client, the solicitor or any other person."[19]

Notably, Lord Bridge disagreed with Lord Goff and Lord Griffiths. He considered the "innocent tool" test to be insufficiently precise and certain, and thus an illegitimate extension of the iniquity exception:

"this development of the law goes well beyond any previous authority and, if it is a legitimate extension of previously accepted principle, it should be capable of being expressed in language sufficiently precise to make clear the boundary within which the new principle is to apply […] The answer proposed by your Lordships to the certified question in terms suggests that the relevant intention for the purposes of section 10(2) may be that of 'any other person' without limitation. The only other language which I find in your Lordship's speeches to indicate the required nexus between the criminal party and the innocent party, who is to be deprived of legal professional privilege for communications with his legal adviser, is that the latter is the 'innocent tool' of the former. If this is intended to serve as a sufficient definition of a new legal principle, I must say, with all respect, that I find it totally inadequate."[20]

17. See generally Thanki, [4.57]; Passmore, [8.009].
18. *Francis & Francis*, 396E–G (Lord Goff).
19. *Ibid*, 385B (Lord Griffiths).
20. *Ibid*, 378.

Subsequently, *Francis & Francis* was applied in *Owners of the Kamal XXVI v Owners of the Ariela* ("*Kamal*").[21] The *dicta* of Lord Goff and Lord Griffith were "specifically applied so as to uphold a challenge to a claim to privilege on the basis of iniquity of a third party"[22] by Burton J, who ruled that:[23]

"the common law is as stated by Lords Goff and Griffiths in Ex p Francis & Francis, and whatever the precise status of the Court of Appeal decision, on the facts or otherwise, in the *Banque Keyser Ullmann SA* case, in this case the innocent underwriters and the innocent solicitors (instructed in part by the innocent underwriters and in part by the fraudulent client) were used as the mechanism for achieving the client's fraud, the fraud exception applies and there is neither legal advice nor litigation privilege available to the underwriters or the solicitors."

However, Burton J raised concerns about the formulation of the test articulated by Lord Goff. He considered the "innocent tool" test to be "unnecessarily pejorative or emotive", preferring instead to consider whether the innocent client had been used by the third party as a "mechanism to achieve his fraud".[24] Regrettably, Burton J did not precisely define the parameters of his "mechanism" test, as the facts of the case were relatively clear-cut.

The correctness of the decision in *Kamal* was not challenged by the parties in *Accident Exchange*;[25] and it was accepted that the fraud exception could apply in third-party cases. However, the difficulty was that the boundaries of the exception in such cases remained ill-defined. In response to this question, Sir Andrew Smith concluded that the proper formulation of the test was whether the innocent third party had been used as an "innocent tool" by the wrongdoer, as suggested by Lord Goff in *Francis & Francis*.[26] Sir Andrew Smith further clarified that the overarching question when applying the "innocent tool" test was whether the third party's iniquity took the client's relationship with his lawyer outside the ordinary course of the lawyer's engagement:

"The question remains whether the relationship between client and lawyer is properly to be regarded as one in the ordinary course of a lawyer's engagement, […] The question therefore arises when the iniquity of a third party so took the relationship of an innocent client with his lawyer outside the ordinary course of the lawyer's engagement that the relationship was not a confidential one."[27]

On the facts, Sir Andrew Smith ruled that the iniquity exception had not been engaged.[28] He reasoned that the Defendant Drivers had not been used as "innocent tools" by AF, as the Defendant Drivers had "an existing lawyer/client relationship" which had been "created and continued for a normal and legitimate purpose", upon which AF's iniquity was "parasitic".[29] The Defendant Drivers approached the Solicitor Defendants for legal advice, and were only later involved with AF in the course of their claims.[30] The mere use

21. [2011] 1 Lloyd's Rep 291; [2011] 1 All ER (Comm) 477 ("*Kamal*"); see generally Thanki, [4.59]; Passmore, [8.014].
22. *Accident Exchange*, [29].
23. *Kamal* [32].
24. *Ibid*, [26].
25. *Accident Exchange*, [31].
26. *Ibid*, [38].
27. *Ibid*, [40]
28. *Ibid*, [49].
29. *Ibid*, [49].
30. *Ibid*, [41].

of AF's services did not make the Defendant Drivers the "tools" of AF.[31] Accordingly, AE's application for inspection was dismissed.[32]

## A welcome decision

Sir Andrew Smith's clarification of the iniquity exception in the context of third-party cases is to be welcomed. His judgment in *Accident Exchange* establishes that privilege will not be overridden in third-party cases merely on the basis that disclosure of the contested documents would assist the court to determine the allegation of iniquity.[33] The iniquity exception will apply only if there is an "innocent tool" relationship between applicant and client, which undermines the underlying professional relationship between the innocent client and their lawyer. Sir Andrew Smith's approach is rooted in House of Lords authority.[34] Further, it is consistent with the rationale of the iniquity exception, *i.e.* that the "absence or abuse of the normal relationship which arises where a solicitor is rendering a service within the ordinary course of professional engagement" entails that privilege does not arise at all.[35] It is likely to be followed by other courts interpreting the iniquity exception.

## Parameters of the "innocent tool" test

In interpreting the "innocent tool" test, four key propositions can be distilled from *Accident Exchange*. These have clarified the iniquity exception in third-party cases considerably from Burton J's analysis in *Kamal*.

First, the "innocent tool" test focuses on the relationship between the innocent client and the iniquitous third party. The "hallmark" of cases in which the exception is engaged is likely to be third-party iniquity "upstream" of the solicitor/ client relationship.[36] There is iniquitous conduct "upstream" when "the wrongdoer and the client have had a relationship (or nexus) separate from the dealings with a solicitor, and that separate relationship was used by the wrongdoer to advance the wrongdoing".[37]

Second, the fact that the client in question "had a proper purpose in taking legal advice or in pursuing or defending litigation" does not mean that the iniquity exception is inapplicable; Sir Andrew Smith emphasised that privilege will be lost in "many cases" like this.[38]

Third, if the relationship between the innocent client and his legal adviser pre-dates the innocent client's relationship with the iniquitous third party, it is unlikely that the iniquity exception will apply. Sir Andrew Smith rejected an argument that AF's involvement over time with the Defendant Drivers took the earlier relationship between the Solicitor

31. *Ibid*, [46].
32. *Ibid*, [99].
33. *Banque Keyser*, 338 (Parker LJ); affirmed at *Accident Exchange*, [26].
34. *Francis & Francis*, 396E–G (Lord Goff).
35. *JSC BTA Bank v Ablyazov (No 13)* [2014] EWHC 2788 (Comm), [76].
36. NB, this is not an "acid test": *Accident Exchange*, [47].
37. *Ibid*, [49].
38. *Ibid*, [46].

Defendants and the Defendant Drivers outside of the ordinary course of professional employment, emphasising that such an argument would involve such a generous interpretation of the "innocent tool" test that it would "seldom, if ever" apply to limit the iniquity exception (as the judge considered Lord Goff intended it should).[39]

Fourth, the scale and nature of the third party's wrongdoing is of limited relevance. Sir Andrew Smith rejected an argument that the exceptionally widespread perjury of AF justified applying the iniquity exception.[40]

Finally, to Sir Andrew Smith's analysis may be added the proposition that the iniquity exception is meant to apply exceptionally.[41] Accordingly, courts are likely to be sceptical of excessively broad interpretations of the "innocent tool" test.

## Conclusion

Far from a complete exposition of the iniquity exception in third-party cases, *Accident Exchange* leaves considerable room for manoeuvre in interpreting the "innocent tool" test. As Sir Andrew Smith himself acknowledged, the "innocent tool" test—which is ultimately "a question of fact and degree"—may rightly be seen as "vague".[42] Nevertheless, *Accident Exchange* is a much-needed clarification of the iniquity exception in third-party cases. It is a firm starting point for the development of further authorities on the "innocent tool" test that is likely to be followed in subsequent cases.

Wei Jian Chan*
Nathan Pillow†

# IN DEFENCE OF *SEMPRA*

*Prudential Assurance v HMRC*

## Background

In *Prudential Assurance Co v HMRC*,[1] their Lordships performed a stunning volte-face in the law of unjust enrichment, expressly departing from the decision in *Sempra Metals Ltd v IRC*,[2] reached by the House of Lords only 11 years earlier. This note seeks critically to examine the reasoning underpinning that remarkable reversal.

The decision in *Prudential* is the latest blow in the litigation which has spawned from the "Franked Investment Income" taxation scheme. The basic facts, though somewhat technical, are by now a familiar sight. Pursuant to the Income and Corporation Taxes

39. *Ibid*, [41–42].
40. *Ibid*, [44].
41. *Crescent Farm (Sidcup) Sports v Sterling Office* [1972] Ch 553, 565 (Goff J).
42. *Ibid*, [48].

* Essex Court Chambers.
† QC, Essex Court Chambers.

1. [2018] UKSC 39; [2018] 3 WLR 652 (hereafter "*Prudential*").
2. [2007] UKHL 34; [2008] 1 AC 561 (hereafter "*Sempra*").