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Welcome to our summer fraud update. In addition to our email updates, we will also, from September, be providing a quarterly fraud update as a webinar. If you would like to be included in the circulation list for this and similar events, please let us know.

In the meantime, we are delighted to welcome Kyle Wombolt and Richard Norridge to the group. Kyle joins our Hong Kong office as a partner. He is a US and Hong Kong qualified lawyer with unique experience conducting and advising on anti-corruption, fraud and accounting investigations. Richard joins as an associate from Allen & Overy. I worked with Richard for several years when I was there and am delighted to work with him again. He has extensive experience of fraud and trust litigation.

A very substantial amount of fraud is carried out by professional fraudsters who rarely stay around to fight out the rights and wrongs of what they have done in court. Every now and then I come across one who does, either because he has to (for example, because he has been arrested) or because he thinks he can extract a settlement by making a nuisance of himself. But against defendants of this kind, the battle is more usually won or lost simply on the question of whether the claimant can locate and seize the assets. By the time of the trial, either the fraudster has spirited the money away and sees no reason to rake over the merits of how he got it or it has been seized and the prospects of trying to get it back are too poor for him to take the risk of a personal appearance. Indeed, if he does take part in the trial, it is often by proxy through parties - often offshore companies – which purport to have nothing to do with him. They too, are usually only there to try to retain assets that the claimant has frozen.

Despite the frequent absence of the culprit at fraud trials there is often a fair amount for everyone to fight about. Often trials are about which of two innocent parties bear the loss in the aftermath of the fraud. A fair proportion of fraud litigation revolves around this issue alone. In this vein, financial institutions are rightly concerned to know when they and others who receive money are regarded as “on notice” of a third party’s claim to it following a fraud. The issue often determines whether or not they or the victim of the fraud are entitled to keep it.

It is no wonder therefore that most of the cases reviewed in this bulletin are about locating and seizing assets or about appropriating fraud loss between parties in the fraud’s aftermath. We also look at the European Commission’s plans to introduce a Europe-wide bank Freezing Order. A draft should be available over the summer of this year and for banks in England, the implications are potentially costly. Just as importantly, we look at the *Sinclair v Versailles* decision with the emphasis on the question of what amounts to “notice” to a bank receiving tainted funds. Another development has rightly received a fair amount of attention: the Bribery Act 2010 comes into force on 1 July. My partner Susannah Cogman and Yang Zhao provide a useful overview.

Robert Hunter
Co-Head of Fraud Group
Delaying asset disclosure under worldwide freezing orders: No more pulling yourself up by your bootstraps?  
JSC BTA Bank v Ablyazov & Others [2010] EWHC 2352 (Comm)

1. Introduction

Few things are as challenging for a defendant as being served with a worldwide freezing order. Almost always it will contain asset disclosure provisions that require him to disclose within a matter of hours his assets whatever they are and to confirm this on affidavit. If the action also includes a proprietary claim, then the order is likely to require him to disclose what has become of assets that the claimant alleges to be his since the claimant parted with them.

Even with the help of experienced and well-resourced solicitors, providing this disclosure can often be a daunting task. Frequently the freezing order is made without notice and therefore comes “out of the blue” to the defendant. It is often undertaken against the backdrop of concerns the defendant will have regarding payment of legal fees, adverse publicity, the start of lengthy legal proceedings and a barrage of correspondence from the claimant’s solicitors who would not have obtained the freezing order unless they thought that it was against someone who could not be trusted and who therefore are not minded to be generous.

English style freezing orders usually require more extensive disclosure than asset disclosure procedures in other jurisdictions. Many defendants, particularly those from overseas, find the requirement objectionable. If the action or the grounds upon which the freezing order was obtained are unjustified, the defendant’s indignation is understandable. However, in our experience, even defendants who know perfectly well that they have committed a fraud are (whether unreasonably or not) genuinely outraged with what they see as an offensive intrusion to their privacy.

It is little wonder, therefore, that so many defendants seek to hold up the asset disclosure process whilst they challenge the jurisdiction of the court to grant the freezing order. In the 1980’s, it used to be common for defendants to seek to give the disclosure by putting it in a sealed envelope deposited in the court. This practice was soon abandoned. Rightly so: the purpose of disclosure is to ensure that the claimant can do what is necessary to “police” the injunction by serving it upon third parties who hold the defendant’s assets or (if they are outside the jurisdiction) taking steps in the countries in which the assets are located. Putting the information in a sealed envelope (so that the claimant does not learn of its contents) rather defeats the point of the exercise. The claimant will not know who these third parties are and will therefore not be able to “police” the injunction or take any steps in relation to any assets identified.

2. The Grupo Torras decision: injunctions need teeth

The abandonment of the “sealed envelope” practice was followed by the decision in Grupo Torras1 in which a worldwide freezing order was granted whilst a challenge to the jurisdiction was afoot. Sheikh Fahad, the principal defendant, sought to persuade the court to delay disclosure that he was otherwise obliged to make pursuant to the freezing order until his challenge to jurisdiction was heard.

If Sheikh Fahad’s challenge succeeded, the freezing order would be set aside and so would his obligation to make disclosure. In the interim, Sheikh Fahad argued, nothing should be done, while that challenge was afoot,
that could not be undone. The gross intrusion into his privacy constituted by a disclosure order was - Sheikh Fahad argued - just such a thing is something that could not be undone. Once the claimants knew of his assets they could not be rendered ignorant of the information if his challenge to the jurisdiction succeeded and it turned out that they should never have learned it.

The Court of Appeal disagreed with Sheikh Fahad’s arguments, taking the opportunity to coin a now much quoted “legal cliché”. If disclosure can be held up by a simple challenge to jurisdiction, then the worldwide freezing order would be “a toothless remedy in the face of rampant international fraud”. Cliché aside, the Court of Appeal pointed out that freezing orders are granted on the basis of an assumption that there is jurisdiction so that disclosure can also be ordered on the assumption that the court has jurisdiction.

This then leads to the question of what happens if the defendant does not comply with the disclosure order? If the freezing order is granted to support proceedings in another jurisdiction, and the defendant cannot be the subject of any action for contempt in England (because he is abroad), then the want of a proper sanction against the defendant does not comply with the disclosure order? This then leads to the question of what happens if the defendant does not comply with the disclosure order?

The defendants had another perhaps more substantial argument. Prior to the Ablyazov decision a number of cases had supported the notion that, where one litigant did not give disclosure, the court could strike-out his claim or defence. The basis for the court doing this was that, by failing to give disclosure, the defaulting party had made it impossible for the trial to be fair. As Millett J said in Logicrose Limited v Southend United Football Club Limited:

“...where the litigant’s conduct puts the fairness of the trial in jeopardy, where it is such that any judgment in favour of the litigant would have to be regarded as unsafe, or where it amounts to such an abuse of the process of the court to render further proceedings unsatisfactory and to prevent the court from doing justice, the court is entitled – indeed, I would hold, bound – to refuse to allow the litigant to take further part in the proceedings and (where appropriate) to determine the proceedings against him.”

Raja v Van Hoogstraten appeared to be another example of this principle. In that case, the Court of Appeal set aside a default judgment against a party who had failed to give disclosure under a freezing order. The principal reason for this was that it had not been clear what, exactly, the defendant had been required to do to comply with the order. However, Chadwick LJ had added, for good measure, (citing the decision in Logicrose):

“There was, in the present case no risk that the failure to make disclosure in aid of the freezing order would put in jeopardy the fairness of a trial of the issues in action. The most that could be said was that failure to make disclosure in aid of the freezing order might lead to a position where the claimant’s success in the action would be rendered nugatory by the dissipation of assets which ought to have remained available to meet any judgment which he obtained.”

3. The decision in Ablyazov

This was the issue that came up in JSC BTA Bank v Ablyazov and Others. First, the defendants argued that no unless order should be made whilst a challenge to jurisdiction was pending. It would be wrong, they said, for judgment to be entered before the court had dealt with the question of whether it had jurisdiction and therefore whether it should be hearing the action at all. Christopher Clarke J dealt with this in a number of ways at various points in his judgment. First, he said that the court expects its order to be complied with and granted the order to secure compliance. Hence it was not open to the defendant to ask the court to weigh in the balance what would happen if the defendant disobeyed the order.

Secondly, he pointed out that the grant of the disclosure order by the Court of Appeal in Grupo Torras must have been with the prospect in mind that it could be enforced only by the sanction of a default judgment. (Indeed, he noted that an unless order had also previously been made whilst a jurisdictional challenge had been pending in CIBC Mellon Trust Co Ltd v Stolzenberg). Thirdly, he pronounced that, were the court not in a position to make such an order, “fraudsters would flourish”. Finally, he noted that since freezing orders are granted on the assumption of certain facts, so can an unless order be made on the assumption that the court has jurisdiction.

The defendants, however, had another perhaps more substantial argument. Prior to the Ablyazov decision a number of cases had supported the notion that, where one litigant did not give disclosure, the court could strike-out his claim or defence. The basis for the court doing this was that, by failing to give disclosure, the defaulting party had made it impossible for the trial to be fair. As Millett J said in Logicrose Limited v Southend United Football Club Limited:

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Some weeks afterwards the Court of Appeal had cited the above passage with approval in Stolzenberg v CIBC Mellon Trust Co. Ltd. The logic of this thinking is clear enough. It is one thing for a court to refuse to hold a trial because it will be unfair (i.e., the court will not be able to “do justice”). It is quite another to decide not to hold a trial because the outcome may not have the commercial benefit that the claimant wanted. Many judgments are unenforceable or of no practical benefit to the claimant: but that is not a good reason to refuse to hear the claim.

This was the distinction that some of the defendants in Abyzov sought to deploy. They argued that a default judgment should not be granted against them for failing to give disclosure under a freezing order. Disclosure of the defendants’ assets will often have little or nothing to do with the question whether there can be a fair trial. On the authorities, it was an attractive proposition. For practitioners, it would have been a disaster (think back to the “toothless remedy in the force of rampant international fraud” cliché).

Christopher Clarke J distinguishing previous cases held that the question was not “…solely whether non-compliance will render further conduct of the proceedings unsatisfactory”. He pointed out that the Logicrose decision had not concerned disclosure under a freezing injunction but that the approach of the other two Lord Justices in that case had indicated a “more robust” approach to litigants whose conduct is liable to …the overall fairness of the proceedings”. The observations of Chadwick LJ in Raja appear to have been regarded by Christopher Clarke J as obiter.

4. Conclusion

The judgment appears consistent with the court having a broad discretion with the emphasis being (prior to judgment being entered) upon the order in question and securing compliance with that order rather than punishing default. Indeed, Christopher Clarke J said that “…the court is entitled to take into account the effect of making, or not making, the order sought on the overall fairness of the proceedings and the wider interest of justice as reflect in the overriding objective”. Whether or not this sits entirely comfortably with previous authorities, for practical purposes, it is clearly the right one. As Christopher Clarke J pointed out, the consequences of a defendant being able to grant himself an extension of time for disclosure under a freezing order by making a challenge to the jurisdiction (however spurious) which might take months to resolve and could be done by almost any overseas defendants would have been disastrous: “Fraudsters would flourish”, as he put it.

Gareth Keillor
1. Overview

A significant amount of asset tracing work now originates from Eastern Europe. Where the parties to a dispute have chosen English law and the English courts as a forum in their contract, the very great differences between the various legal systems that the parties may be used to gives rise to difficult issues of conflict of laws.1

This case involved an application for a freezing order arising from a share sale agreement. In considering whether to grant a freezing order over the proceeds of the sale of shares to a third party, in breach of a Sale and Purchase Agreement (SPA), the court considered whether the applicant, Luxe Holding Limited (Luxe), might have a proprietary claim to the proceeds.

The court confirmed that the question of whether Luxe had a proprietary claim should be decided under English law because the SPA was governed by English law. It did not matter that a proprietary claim might not be recognised in the countries in which the shares were held.2

2. Facts

Midland Resources Holding Limited (Midland), a company incorporated in Guernsey, agreed to sell its shares in various companies, the majority of which were Russian or Ukrainian companies, to Luxe, a company incorporated in Cyprus, pursuant to an SPA. The SPA was governed by English law and the parties agreed to submit to the exclusive jurisdiction of the English courts. There was also a clause in the SPA which stipulated that Midland would pay a US$50 million “fine” if it failed to perform its obligations.

Less than two weeks before the shares were due to be transferred to Luxe, Midland gave notice that it was pulling out of the deal and had sold the shares to a third party. Midland accordingly returned the payment made by Luxe as well as a further US$50 million for payment of the “fine”.

Luxe alleged the failure to complete the sale was a breach of the SPA. Midland argued the SPA was insufficiently certain to be enforceable,3 or that alternatively on its true construction the SPA allowed Midland to withdraw on payment of the US$50 million “fine”.

3. The proprietary claim

Luxe argued that it had acquired a beneficial interest in the shares as of the date of the SPA. When the shares were sold to a third party in breach of the SPA, the beneficial interest transferred to the proceeds of the sale obtained by Midland, insofar as these exceeded the balance of the price that Luxe would have had to pay.

Midland submitted that ownership of the shares was governed by lex situs, which was Russia or Ukraine. Ukrainian and Russian law do not recognise beneficial interests. Further, Midland could not have had a proprietary interest in the shares as they were held through subsidiaries, so it could not have passed a beneficial interest to Luxe.

The court held that Luxe had at the very least a good arguable case in the form of a proprietary claim. A quasi trust arose because the SPA was specifically enforceable – the obligation to be enforced was that Midland must procure that the shares were transferred.

Mr Justice Roth said (at paragraph 31):

“...I think it is necessary to ask what sort of trust, and thus beneficial interest, arises on the sale of land or of shares in private companies: in such a case, a trust arises only because the agreement is specifically enforceable. In a sense, therefore, it is the corollary of the remedy of specific performance. Thus it is not a full trust in the classic sense. The nature of the trust which arises on the exchange of contracts for the sale of land … has been described as a “qualified trust” and the vendor has been referred to by Lord Greene MR as “a quasi-trustee.”4

Hence Luxe had a sufficient interest in the subject matter of the contract to trace in equity into the proceeds of the sale to the third party.

The court held that the applicability of lex situs to questions of ownership did not alter the position as between the contracting parties. Equity acts in personam – the parties had chosen to govern the relationship between them according to English law, so “they have voluntarily subjected themselves to the English system of remedies.”5
It was accepted by Luxe that any beneficial interest in the shares was terminated when they were sold to the third party, and its claim was to the proceeds in Midland’s hands. Thus, there was no interference with the property transfers under Ukrainian or Russian law.

4. Freezing order – risk of dissipation

Mr Justice Roth considered that to obtain the freezing order Luxe had to show there was a real risk of dissipation by Midland.6

The following factors were considered relevant:

• Midland had no assets in the UK, and only very limited cash deposit assets in other EU countries, which could be moved very rapidly.

• It had substantial real estate assets in Russia, held through subsidiaries.

• Interestingly, one factor was disregarded. Luxe submitted that enforcement of an English judgment against real estate assets in Russia is very difficult. Mr Justice Roth said:

“Luxe chose to contract with Midland and agreed that exclusive jurisdiction under the contract should rest in the English court. Any difficulties that may exist regarding enforcement on Russian assets (as to which I make no findings) are therefore inherent in doing business with Midland and cannot, in my judgment, constitute a risk of dissipation that can justify a freezing order.” (at paragraph 62).

• There was evidence Midland had been able to very quickly re-organise the ownership of its Russian assets to transfer them out of the reach of Luxe.

• The court considered whether, applying guidance from Gee on Commercial Injunctions, there was evidence Midland had an “unacceptably low standard of commercial morality giving rise to a feeling of uneasiness about the defendant”. Mr Justice Roth said there was evidence Midland and its solicitors had misled Luxe on a number of occasions, by indicating that the sale to Luxe was going ahead and that, once the breach had become clear, it was premature for Luxe to seek an injunction even though it was in fact a matter of great urgency. Mr Justice Roth said that Midland had intended to give Luxe false assurances and:

“[T]he fact that Midland has engaged in such dissimulation so as to frustrate effective recourse to the English court, in my judgment provides real grounds for serious apprehension that it would act so as to place its assets out of the reach of Luxe as a judgment creditor.” (at paragraphs 66 and 67).

The court granted the freezing order. Perhaps most importantly, this case serves as a warning that when contracting with parties whose assets are based in foreign jurisdictions, a party may be deemed to have accepted the risk of enforcing judgment against those assets.

Elizabeth Brogan

footnotes


2. The decision was in line with previous authority in this respect. See, for example, El-Ajou v Dollar Land Holdings Plc (No.1) [1993] 3 All ER 717; [1993] BCC 698; [1993] BCLC 735.

3. The SPA contained provisions that: (i) the parties agreed to enter into a Restated Agreement some three weeks after the SPA was signed; and (ii) failure to sign the Restated Agreement did not affect the parties’ obligations pursuant to the SPA.

4. Roth J referred to Lysaght v Edwards (1876) 2 Ch D 499 and Englewood Properties v Patel [2005] EWHC 188(Ch), [2005] 1 WLR 1961 at [41]-[42]. The court was also guided on this point by Mr Justice Walton’s judgment in Lake v Bayliss [1974] 1 WLR 1073, which was cited with approval in A-G v Blake [2001] 1 AC 268 at 284D.


6. Previous authorities have suggested that it is unnecessary for a proprietary claim to show a risk of dissipation. There is no record of the court having considered these.
The Bribery Act 2010: corporate offence and adequate procedures

After much fanfare and comment, an unexpected delay, and the publication of government guidance that has divided critics, the Bribery Act 2010 (the Act) will finally be brought into force on 1 July 2011. This article provides a brief overview of the Act and the ‘adequate procedures’ which companies may wish to consider implementing in response to its advent.

Key points at a glance

- The Bribery Act will come into force on 1 July 2011.
- The new ‘corporate offence’ will impose liability on companies for the acts of employees and third parties who pay bribes on the company’s behalf, subject only to the company being able to demonstrate that it had an adequate anti-corruption programme in place.
- The offence applies extra-territorially to UK companies and to non-UK companies which carry on part of their business in the UK.
- The government’s ‘adequate procedures’ guidance contains some significant clarifications in the relation to the intended scope of the Act.
- The guidance sets out six core principles, supplemented by additional commentary, to assist companies in developing their compliance programmes.

1. The impact of the Act

The Act creates several new offences, carrying a maximum penalty of 10 years’ imprisonment or an unlimited fine for individuals, and an unlimited fine for commercial organisations. These are:

- active bribery (offering, promising or giving a bribe);
- passive bribery (requesting, accepting or agreeing to accept a bribe);
- bribing a foreign public official; and
- a ‘corporate offence’ of failing to prevent bribery.

For an in-depth analysis of the new offences, see Herbert Smith’s corporate fraud, investigations and asset recovery update, dated June 2010.

The Act is significant both because of its sweeping provisions and because it is likely to be enforced. Traditionally, the UK has had a deplorable record of prosecuting corruption offences, particularly in relation to bribery overseas. That has changed, and over the last few years the Serious Fraud Office (SFO), under its director Richard Alderman, has begun to build a track record of convictions and civil recovery orders in response to corruption incidents.

Corporate prosecutions

The Act will strengthen the SFO’s hand, in particular, in relation to prosecutions of corporate entities. Existing UK corruption law is already relatively wide-ranging and extra-territorial in scope, but prosecuting companies is challenging because of the need to satisfy the ‘identification principle’: that someone sufficiently senior within the company to be regarded as its ‘directing mind and will’ had the relevant corrupt intent. The Act will address this issue through the introduction of the new corporate offence (section 7 of the Act). This offence imposes strict liability on organisations where persons performing services on the organisation’s behalf commit the ‘active bribery’ or the ‘foreign public officials’ offence with the intention of obtaining business, or a business advantage, for the organisation. In such circumstances, the organisation’s only line of defence will be to prove that it had ‘adequate procedures’ in place designed to prevent such persons from committing acts of bribery.

In short, the corporate offence may impose liability on a company for the acts both of its employees (who will be rebuttably deemed to perform services on its behalf) and a potentially very wide range of third parties. As ‘adequate procedures’ are the only way to mitigate this risk, many companies are in the processes of reviewing or implementing anti-corruption programmes before the Act comes into force in July.

Extended jurisdictional reach

The impact of the Act is compounded by its extra-territorial scope. The active and passive bribery offences, and the foreign public officials offence, apply to the acts of UK-incorporated companies, British citizens and UK residents, worldwide, as well as to acts done in the UK. More alarmingly, the corporate offence also applies to
the overseas acts of non-UK incorporated companies, if those companies carry on part of their business in the UK (section 7(5)(b) of the Act).

The SFO has sought to emphasise the application of the Act to non-UK companies, in part, it is thought, in response to criticisms that the Act will be bad for British business. The question of whether they will, in practice, chose to focus their resources, remains to be tested. In the interim, however, there has been a focus on the question of what is meant by “carry[ing] on… part of a business…in the UK”, ie, what degree of nexus to the UK is necessary before a company, and its worldwide activities, are caught by the Act.

Significant scope clarifications in the guidance

At the end of March, the government published its long-awaited and pithily entitled ‘Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010)’, which is the statutory guidance on adequate procedures required to be published by the Act. As well as guidance on anti-corruption programmes, this document contains important commentary on the Act, including a significant ‘gloss’ on a number of key areas of uncertainty.

Three of the most significant clarifications in the guidance are:

• In relation to jurisdictional scope, the suggestions that:
  (a) a test of ‘demonstrable business presence’ may be appropriate; (b) that the fact that a company has a UK subsidiary will not, in and of itself, necessarily mean that the parent entity carries on part of its business in the UK; and (c) that a UK listing will not, in and of itself, amount to carrying on a business here.

• Additional commentary on the meaning of ‘associated persons’, ie, the persons performing services on behalf of a company, whose actions can trigger the commission of the corporate offence. The consultation draft of the guidance, published last year, had suggested that an impractically broad range of third parties (including suppliers of goods, a company’s entire supply chain, and, virtually, the kitchen sink), might be regarded as falling within this definition, such that those parties should be subject to due diligence and other anti-corruption risk mitigants. Thankfully, the guidance now reverts to a test which tracks more closely the language of the Act itself.

• A significant re-interpretation of the foreign public officials offence (section 6 of the Act), to ‘read down’ the importance of the fact that the offence does not, on its face, require an advantage to be provided to an official with an intent to influence the official to act improperly. It is sufficient, on a strict reading of the Act, to intend to influence the official and to obtain a business advantage.

The guidance must be approached with a degree of caution (as it simply reflects the current government’s view of what the Act was intended to mean, and is not a ‘safe harbour’ as such). Notwithstanding the new guidance, dealings with public officials clearly present a higher risk than dealings in the private sector. The clarifications are, however, welcome, and do carry some weight; it is notable that the guidance issued jointly by the Director of Public Prosecutions and the director of the SFO in relation to their approach to prosecutions under the Act (the Directors’ Guidance) confirms that the adequate procedures guidance will be taken into account in considering any prosecution for the corporate offence.

2. Adequate procedures

By comparison to the excitement of the scope clarifications referred to above, the core guidance as to the ‘adequate procedures’ which companies should put in place to prevent bribery by their associated persons may come as something of an anti-climax. Nonetheless, it deserves careful reading. The guidance sets out six broad principles which are intended to guide companies in determining what bribery prevention measures to put in place, together with additional commentary (which is outside the scope of this briefing) on each principle. The six principles are:

• Proportionate procedures – A commercial organisation’s procedures to prevent bribery by persons associated with it are proportionate to the bribery risks it faces and to the nature, scale and complexity of the commercial organisation’s activities. They are also clear, practical, accessible, effectively implemented and enforced.

• Top level commitment – The top level management of a commercial organisation is committed to preventing bribery by persons associated with it and are proportionate to the bribery risks it faces and to the nature, scale and complexity of the commercial organisation’s activities. They are also clear, practical, accessible, effectively implemented and enforced.

• Risk assessment – The commercial organisation assesses the nature and extent of its exposure to potential external and internal risks of bribery on its behalf by persons associated with it. The assessment is periodic, informed and documented.
• **Due diligence** – The commercial organisation applies due diligence procedures, taking a proportionate and risk based approach, in respect of persons who perform or will perform services for or on behalf of the organisation in order to mitigate identified bribery risks.

• **Communication (including training)** – The commercial organisation seeks to ensure that its bribery prevention policies and procedures are embedded and understood throughout the organisation through internal and external communication, including training, that is proportionate to the risks it faces.

• **Monitoring and review** – The commercial organisation monitors and reviews procedures designed to prevent bribery by persons associated with it and makes improvements where necessary.

### 3. Conclusions

The Bribery Act creates significant new legal risk for many companies. Whilst it does not impose any positive compliance obligation on companies to implement an adequate procedures programme, a ‘do nothing’ approach may therefore be a very high risk strategy. Companies which do wish to take action in response to the Act now have until 1 July 2011 to review their existing policies and procedures to ensure they are ‘adequate’ for the purposes of the Act.

Susannah Cogman

Yang Zhao
Europe-wide freezing orders: the likely regime

In 2006, by the Green Paper on Improving the Efficiency of the Enforcement of Judgments in the European Union: The Attachment of Bank Accounts, the European Commission proposed the creation of a European Attachment Order (EAO) over defendants’ bank accounts in Member States. A public consultation process on the scope and operation of the proposed EAO regime has been ongoing since 2006. The European Commission is expected to publish its draft regulation in summer 2011, which means the regulation could well be in force by 2013.

1. Applying for a Europe wide freezing order – what will be involved?

The process of obtaining an EAO is expected to be similar to obtaining a freezing injunction in England and Wales. Whilst the terms are still being finalised, the European Commission’s publications indicate the procedure and scope of the EAO will be along the following lines:

- Attachment proceedings will need to be commenced where the substantive claim will be heard. The priority of competing creditors will be determined as a matter of national law although as yet no detailed consideration has been given to competing creditors in different jurisdictions or creditors who are domiciled in the same jurisdiction but commence proceedings in another Member State.

- Applications will be able to be made from before the commencement of proceedings through to the point at which a claimant obtains a declaration of enforceability. Where an EAO is sought prior to the launch of an action, a claimant will be required to commence proceedings shortly thereafter.

- Presumably, most applications will be without notice, to preserve the element of surprise and ensure that the debtor takes no steps to drain the account prior to attachment. If so, a claimant will be under a duty to provide full and frank disclosure.

- A claimant will not be entitled to interrogate a debtor or seek disclosure of a debtor’s assets. If the bank account details (at least the account name and branch) are not known, the court will be unlikely to grant the EAO. An EAO is also unlikely to be granted in circumstances where the funds sought to be frozen are held in a nominee account. Whilst there is scope for joint accounts to be frozen, only the debtor’s proportional ownership of funds will be affected and notice will need to be given to the other account holders.

- No EAO will be granted unless the claimant has a prima facie case and a prospect of a difficult recovery, such as a risk of dissipation. The EAO will be able to be enforced against several bank accounts but the creditor will not be entitled to freeze more than the amount of his claim plus interest and costs.

- In most cases a creditor will be obliged to provide security for any loss which may be suffered by the debtor or a third party such as a bank. A creditor will also be required to pay a fee to the bank(s) freezing the debtor’s account(s).

- There will be scope for a debtor to challenge the grant of the EAO shortly after his account has been frozen. Most likely, such a challenge must be made in the court in which the EAO was issued.

### EAO – key points at a glance

With likely implementation in 18 months to four years, an EAO:

- Should allow a creditor to attach a debtor’s European bank accounts without the need for a declaration of enforceability
- Will have the effect of freezing a debtor’s bank account – but without creating a proprietary right or giving any right of transfer
- Will most likely be obtained by a process similar to an application for an English freezing order and subject to a similar test – but will not allow a debtor to examine the creditor or obtain information as to his assets
- Is unlikely to be effective where the location of the proceeds of fraud is unknown or the proceeds are outside the EU, or where the proceeds are held in a nominee or joint account
How will the Europe wide freezing order work – in rem or in personam?

- Anyone who has tried to freeze assets in Europe will know that freezing orders fall into two broad categories. First, there are attachments “in rem”. These work effectively by declaring that once the attachment has been granted any further dealing with the asset is of no legal validity. Most civil law jurisdictions operate this form of attachment. It has certain similarities with, for example, the English order nisi.

- Secondly, there are attachments “in personam”. These do not have any immediate effect upon the legal validity of any dealings by the defendant with his assets. They merely prohibit him (usually subject to limited exceptions) from giving effect to them. If a defendant deals with an asset that is subject to a freezing injunction, the transaction will be prima facie valid but the defendant will be at risk of contempt of court. Some European countries (for example, France and Germany) operate a combination of attachments in rem and in personam such that not only is a transaction involving the attached asset void, but the defendant is also liable for a punishment if he effects it.

- There are significant issues as to how in rem and in personam injunctions operate internationally. Each has its limitations. The courts of most countries are prepared to make court orders that have some impact upon people outside the borders of that country. However, countries that operate in rem attachments will not generally seek to make orders invalidating dealings with property in other countries. Aside from the usual conflict lawyers’ jargon about “judicial comity”, “judicial chauvinism” and “extra territoriality”, the simple fact is that the order is likely to be ignored without any difficulty and the court that grants it will have its authority undermined.

- Similarly, whilst in personam freezing injunctions are granted by courts over defendants who are outside the jurisdiction of the court granting them, unless there is any real sanction against the defendant for breach of the injunction, the court is unlikely to grant it. Freezing injunctions are not gestures – they must be capable of being enforced. Whenever a defendant is present within the jurisdiction, however, or a default judgment can be granted against him, that sanction is usually deemed to exist.

- Amongst the number states of the European Union, the vast majority of injunctions are exclusively or predominantly in rem. We can therefore expect that the EAO will be akin to an in rem procedure.

- The debtor will almost certainly be entitled to deduct sums from the frozen account to pay his and his family’s living and legal expenses.

2. Problems for victims of fraud

Evidence suggests that in a debt recovery context, a creditor will often seek an attachment order to exert commercial pressure on the debtor and there is considerable concern to ensure that a debtor is not unduly prejudiced by an EAO. Whilst such concern is understandable in the context of debt recovery, the opposite is often true in fraud claims, where a fraudster may well attempt to inflate his costs to further whittle away the victim’s funds, thereby emphasising the need for a robust attachment regime.

Large scale or sophisticated frauds inevitably involve the hiding of funds in offshore jurisdictions where enforcement is difficult. The advent of the EAO will only serve to encourage this: a fraudster will be able to immediately render the EAO a toothless tiger by diverting all funds to accounts outside of the EU. If this presents difficulties for the fraudster, there remains the option of placing the funds in a nominee account in the EU, several entities removed from the fraudster.
It is also difficult to see how an EAO in isolation will assist a victim of fraud. In many cases, the victim will have a suspicion, but no proof, as to where his funds have been routed and/or who to. Victims are often reliant upon the remedies offered in England which entitle a claimant to obtain a freezing order requiring extensive disclosure of assets and allowing cross examination of the fraudster where the disclosure is insufficient, or Norwich Pharmacal relief.

3. More cost to banks

There is a lot to concern banks and practitioners about what is coming. Other European jurisdictions have very quick and easy methods by which bank accounts can be searched centrally and with no cost or expense to the bank. Any legal adviser to a bank in England, however, will know just how inconvenient the process of searching can be. In the past the consequent expense has been something that English banks have been prepared to “take on the chin”, often not even troubling to charge the claimant for the cost of their search, despite being entitled to. That cost may, however, now be multiplied. It is one thing to accept as an overhead the freezing injunctions granted by the courts of England. It is quite another to accept as a matter of routine the cost of searching under the freezing injunctions granted by the courts of every other Member State.

Lucy Westwood

footnotes

1. The fraud

The Sinclair decision results from a recovery action following the collapse of a loan kiting scam orchestrated by Carl Cushnie in the late 1990s. Mr Cushnie convinced a number of investors (Traders) that his company Trading Partners Limited (TPL) engaged in trade finance. The Traders invested their funds, and, pursuant to an agreement between TPL and Versailles Trade Finance Limited (VTFL, another Mr Cushnie-controlled company), the Traders’ funds were held on trust for them or TPL by VTFL until such time as they were used for a trade. Profits from TPL’s and VTFL’s business were funnelled into Versailles Group plc (VGP), which was indirectly owned by Mr Cushnie.

In reality, there was only ever one legitimate trade finance transaction, which made a loss. Yet to the outside world, the Versailles Group was extremely successful. In 1999 the group was valued at more than £600 million. By bouncing the Traders’ money between TPL, VTFL, VGP and a host of other companies (known as “cross firing”), the companies were made to appear as though they were profitably engaging in trade finance ventures.

The existence, extent and implications of the fraud appeared by degrees from around November 1999, rather than in a single blinding revelation. In January 2000, VGP’s and VTFL’s lenders appointed PwC to investigate their affairs, and in late January 2000, PwC were appointed as administrative receivers. Through the receivers, the banks managed to salvage something for themselves from the disaster and various distributions were made to them.

2. TPL’s claims

One of the defrauded Traders, Sinclair, took an assignment of TPL’s claims against VTFL, and made two proprietary claims. First, it claimed to have a proprietary interest in the proceeds from Mr Cushnie’s sale of some of his shares in VGP (the unauthorised profit claim). Since Mr Cushnie has sold them before the fraud was discovered, the proceeds were substantial. Second, it made a proprietary claim to the Traders’ funds (paid to TPL) which were held on trust by VTFL (the mixed fund claim, arising from VTFL’s trustee-like duties to TPL).

The significance of proprietary claims

The fact that TPL asserted proprietary claims, as opposed to personal claims, is critical. Where a fraud has been committed and/or a party seeks to recover funds in an insolvency context, a proprietary claim can mean the difference between recovering everything or virtually nothing, especially if the victim’s property has been passed to a third party or there are secured creditors. Ordinarily, a proprietary claim enables a claimant to:

• capture any uplift in the value of the asset received, before or after receipt;
• obtain income generated by the asset in question since receipt;
• by means of tracing, assert equivalent rights to substitute assets;
• make prima facie claims (both personal and proprietary) against others who receive the property or its proceeds; and
• take priority in insolvency over general creditors.

3. The issues

There were three key issues:

• whether TPL had a proprietary interest in the proceeds of the sale of VGP’s shares (ie the unauthorised profit claim);
• if so, whether TPL could trace into monies paid by Mr Cushnie to the receivers as part of a settlement of claims by VGP and VTFL, which had been taken by the banks; and
• whether TPL had a proprietary claim to, and could trace into, VTFL’s funds which had also been distributed to the banks (ie the mixed fund claim).
In relation to the second and third issues, the key element was when the banks became “on notice” of TPL’s claims against VGP and VTFL.

4. Unauthorised profit claim

The legal framework

It is well established law that a fiduciary is liable to account to the person to whom he owes such obligations for any gains arising from his position as a fiduciary. The question is whether that person can also say that gains are his property and held by the fiduciary for him as such. Typically, this covers situations where a fiduciary establishes a rival business using inside knowledge or takes a bribe. In this situation, the fiduciary is said to hold his gains as “constructive trustee” for the claimant.

There have been two conflicting lines of authority on the issue, only one of which (commencing with Reid) arguably entitled the claimant to bring a proprietary claim against a fiduciary who had made an unauthorised profit. Lewison J identified the two classes of cases. First, those cases where the defendant receives the trust property as a trustee under a transaction which nobody seeks to impugn and secondly, where his receipt of the benefit is itself a cause of complaint. In the first kind of case a proprietary claim arises. In the second it does not. Hence if a trustee misappropriates his beneficiaries’ assets the beneficiaries will have a proprietary claim to them, but if he takes a bribe or makes an unauthorised profit they will not. They do not challenge that he is a trustee, but they do challenge his taking the bribe or making the unauthorised profit.

The findings

Recognising that Reid was not binding upon him, Lewison J rejected the unauthorised profit claim, holding that:

“A claim made in relation to unauthorised profits made by a company director otherwise than by acquiring and subsequently exploiting property formerly owned (or treated as owned) by the company itself falls within the second class of case”.

The Court of Appeal found that Lewison J was right to reject TPL’s claim, although it limited its consideration of this issue to whether Reid should be followed (ie a proprietary claim would arise) in preference to contrary findings in at least five Court of Appeal cases. The Master of the Rolls considered that “[s]ave where there are powerful reasons to the contrary, the Court of Appeal should follow its own previous decisions”. In this instance, the Court of Appeal did not consider that there were powerful reasons to the contrary. The Master of the Rolls recognised that:

“… on the basis that the misuse of the funds by Mr Cushnie in breach of his fiduciary duty was intended to, and did, enable him to make a profit, there is some common sense attraction in the notion that the profit should be beneficially owned by those to whom he owed the duty”,

but he did not consider the risk that a fiduciary might not be stripped of the profits of his fraud to be a “powerful reason” to follow Reid, stating:

“… there is obvious force in the contention that the mere fact that the breach of duty enabled Mr Cushnie to make a profit should not, of itself, be enough to give TPL a proprietary interest in that profit. Why, it may be asked, should the fact that a fiduciary is able to make a profit as a result of the breach of his duties to a beneficiary, without more, give the beneficiary a proprietary interest in the profit?”. The clear implication of this statement was that the courts should be cautious about extending any proprietary rights, which in an insolvency, would be at the expense of the unsecured creditors. The Master of the Rolls considered that any inequity “might well be met by ordering an equitable account”.

5. Notice

When will someone have notice of a claim?

A recipient of trust property will have good title to that property if he acquired it for value, as a bona fide purchaser, without “notice” of the claimants’ equitable proprietary claim at the time he acquired the property. Lewison J held that “notice”:

- is notice of a right rather than a mere claim;
- includes notice of the facts on which the claim is based and of the law applicable to the facts; and
includes both actual notice and constructive notice. Constructive notice means notice of those things that would have been discovered if “proper steps” had been taken. What are “proper steps” depends upon the context in which the question arises. In a commercial context it must be obvious that the transaction was probably improper.

The Court of Appeal agreed with Lewison J’s findings, stating that the issue of notice:

“would be determined by asking what the banks actually knew, and what further enquiries, if any, a reasonable person, with the knowledge and experience of the banks, would have made, and in the light of that, whether it was, or should have been, obvious to the banks that the transaction was obviously improper ...

In this case … the question which the Judge had to determine was whether, on the facts known to the banks … a reasonable person with their attributes (ie those of a responsible large bank, with the benefit of highly experienced insolvency practitioners as their appointed administrative receivers) should either have appreciated that a proprietary claim probably existed or should have made enquiries or sought advice, which would have revealed the probable existence of such a claim”.

Just how much does a bank have to know to be “on notice”?

What makes Sinclair of tremendous importance to banks, receivers and liquidators is not the legal test to be applied to determine if someone has notice (as outlined above), but the strict manner in which the courts are likely to apply it.

Lewison J and the Court of Appeal considered the banks’ actual and constructive knowledge of TPL’s claims at three points in time. None of the following events, which took place before the three relevant points in time, were considered sufficient to put the banks on notice of TPL’s claims:

• PwC produced three reports regarding VGP’s and VTFL’s affairs within a month of their appointment as investigators. The reports identified Traders’ debts of £22.6m. The first report concluded that the persons who funded VTFL through TPL “were also the victims of the fraud and had lost substantial funds”.

• The banks had been advised that there might be claims against Mr Cushnie and in a bank memo it was concluded that “it is highly likely that other parties (shareholders, Versailles Traders) who have also suffered would look to join in any claim thereby reducing our eventual recoveries from [Mr Cushnie]”.

• TPL’s liquidators met with PwC on various occasions. At one meeting the liquidators said they were interested in a tracing process. At another, PwC’s notes recorded that the Traders considered they had a proprietary claim to trump the banks, two Traders were intent on pursuing Mr Cushnie, and monies were all put into the same pot.

In agreeing with Lewison J’s findings, the Court of Appeal held that:

• “although there was plenty of evidence to support the contention that TPL had a [personal] claim in relation to the monies that it had paid over to VTFL, it never occurred to [PwC] or the banks that TPL had a proprietary claim in respect of these monies” until shortly before the third date in question; and

• it was not clear at any point before the third date that there would be a claim against Mr Cushnie in respect of the unauthorised profits or that there was a proprietary interest in the mixed fund.

Accordingly, Lewison J concluded, and the Court of Appeal agreed, that the banks had not been on notice of TPL’s proprietary claims at any point prior to the three dates in question.

What does “notice” mean in practice?

Where a bank or experienced insolvency firm discovers that an entity has been part of a fraud, it seems likely that one of the first matters they will consider is whether there is a risk of a proprietary claim. This is particularly the case for secured creditors: whilst personal claims do not directly impact upon their prospects of recovery, proprietary claims do. However, Sinclair suggests that the issue of notice will not be of concern unless:

• the person who has received trust monies can identify the equitable owner of the monies (ie can identify the potential claimant);

• the potential claimant has asserted a proprietary right to the monies (rather than a mere personal claim);

• the subject matter of the claim is identified; and

• the person who has received trust monies is aware of the potential defendant (ie the fiduciary who has breached his duties).
The decision seems hard to square with other areas of law which put a bank at hazard when it suspects something unwelcome about funds it receives. For example, if a bank suspects that the funds it receives are criminal property, it is unlikely to avoid liability under the Proceeds of Crime Act 2002 merely because it did not know the identity of the victim or that a claim had been made by him to the money. Similarly, on a knowing receipt claim, one would expect there may be circumstances where the court would find that it would be unconscionable for the bank to retain the benefit of the receipt notwithstanding that the bank was not aware of the same two matters. Yet one would expect the both tests to require more culpability on the part of the bank. Indeed, in Sinclair, the defendants tried to argue that the test in relation to what the banks knew was that applicable to knowing receipt of trust property, presumably on the basis that this would result in a more stringent test.

There are real grounds to expect the courts to row back from the notice requirements that were apparently applied in Sinclair. In the interim, the clear message to interested parties is to keep any such thoughts off the books and to wait for, rather than to anticipate, a proprietary claim.

Lucy Westwood

footnotes

1. Sinclair Investments (UK) Ltd v Versailles Trade Finance Limited (in administrative receivership) [2010] EWHC 1614 (Ch) (Lewison J (Sinclair (Lewison)), upheld by the Court of Appeal in [2011] EWCA Civ 347 (Master of the Rolls, Richards LJ and Hughes LJ) (Sinclair (CA)).

2. The mixed fund claim is not considered in this article. In summary, the Court of Appeal agreed with Lewison J’s finding that the principle set out in Cook v Addisyon [1869] LR 7 Eg 466 (where a trustee mixed funds with his own property so that the funds cannot be separated, he is liable for the whole) should apply unless it is more probable than not that the mixed fund or its identifiable substitutes were not derived from the monies held on trust: Sinclair (Lewison) at [154] and [155]; Sinclair (CA) at [141].


4. Part of the problem is that some people use the term “constructive trustee” to mean someone who is personally liable to account in equity and others use it to mean someone who holds assets that are subject to an equitable proprietary claim. The lines of authority were (1) the “no unauthorised profit” cases, including Attorney General of Hong Kong v Reid [1994] 1 AC 324 (a non-binding Privy Council decision which relevantly held that a proprietary claim arose in relation to bribes); and (2) the “Limitation Act” cases, which considered when section 21 of the Limitation Act 1980 would apply to actions to recover trust property from a “constructive trustee”.


6. Sinclair (Lewison) at [80], which reasoning is based upon Millett LJ’s statement in Paragon Finance plc v D B Thakerar & Co [1999] 1 All ER 400 at 408 (considering the Limitation Act cases).

7. Sinclair (CA) at [51].

8. Sinclair (CA) at [52].

9. Sinclair (CA) at [79].

10. Sinclair (CA) at [108].

11. Sinclair (CA) at [100] (referred to in the Court’s findings at [108]) and [109].


13. Sinclair (Lewison) at [123].

14. Sinclair (Lewison) at [135].

15. Sinclair (CA) at [115], [145] and [146].

16. Sinclair (CA) at [116].

17. Whilst an offence does not arise under section 329 of POCA if a person acquires property for adequate consideration, there are other circumstances in which the receipt of funds may give rise to liability of a party transferring or receiving criminal property.

18. Sinclair (Lewison) at [83].
1. Introduction

Most reading this will know that freezing orders are granted to prohibit defendants from disposing of or dissipating their assets in a way that will prevent the claimant from enforcing any judgment he obtains. If the defendant disobeys, he is at risk of contempt. But the primary purpose of contempt is to punish the defendant. Many claimants will simply be concerned to ensure that the defendant’s money is frozen. One way of assisting in the location and securing of the assets in question may be for the claimant to apply to court for the appointment of a receiver over the defendant’s assets.

The court has always had the ability to appoint a receiver over assets that are subject to rival claims as to their ownership (proprietary claims). However, as Section 37(1) of the Supreme Court Act 1981 also gave it the authority to appoint a receiver (in the same way as it can grant a freezing injunction) in cases where it appears the court to be “just and convenient” to do so. In JSC BTA Bank v A, the Court of Appeal described the appointment of a receiver as “…a very intrusive remedy”. It clearly is. Even when there is a proprietary claim, few defendants will want the stigma of a receiver controlling the assets that they hold. Fewer still will like the receiver communicating with third parties about their dealings without them knowing. None will like the prospect of the threat of contempt of court if they interfere with the receiver carrying out either of these tasks.

Appointment of a receiver pursuant to a freezing order

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<thead>
<tr>
<th>Potential advantages for the claimant</th>
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<tr>
<td>1. May assist in the retrieval of assets.</td>
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<td>2. Often useful with assets that require sale, to ensure that the process is dealt with at arm’s length.</td>
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<td>3. Can assist with overseas assets in jurisdictions where the receiver’s title will be recognised.</td>
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<table>
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<tr>
<th>Potential disadvantages for the claimant</th>
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<tr>
<td>1. Can be more expensive than the claimant would wish.</td>
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<tr>
<td>2. Can remove the claimant from the driving seat regarding asset disclosure and seizure.</td>
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<tr>
<td>3. The receiver may prove more cautious than the claimant would like.</td>
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2. **JSC BTA Bank v A**

What are the circumstances that might lead to the appointment of a receiver under s37(1)? The decision in **JSC BTA Bank v A** gives some pointers.

The defendant, Mr A, is a wealthy businessman from Kazakhstan who is said to own or control assets worth in excess of US$ 1 billion through a complex scheme of offshore holding companies. The claimant bank commenced proceedings against Mr A in August 2009 alleging that Mr A had misappropriated funds while he was chairman of the bank. A freezing order was issued against him together with an order restraining him from leaving the jurisdiction. Mr A denied all claims and alleged that they were part of a politically motivated action to take control of his assets, directed by the President of Kazakhstan, due to his status as a leading figure in Kazakhstan’s democratic opposition.

The bank alleged that Mr A had not complied with the freezing order inasmuch as he had been reluctant to disclose his assets and had broken the terms of the order by disposing of some of his assets. In making a receivership order, Teare J found that although Mr A had not actually broken the terms of the freezing order, he had made “seriously inadequate” disclosure and there were grounds to believe (given his conduct) that he may use the complex structure by which he held his assets to deal with those assets in breach of the freezing order. Mr A appealed the decision on the grounds that the judge:

- applied the wrong test for making a receivership order and should have held that such an invasive remedy should only be made if the judge was actually sure that Mr A would breach the freezing order;
- was wrong to attach weight to admittedly inadequate initial disclosure; and
- was wrong in respect of one finding of non-disclosure, on the basis of evidence unearthed after the draft judgment was distributed.

The Court of Appeal dismissed the appeal and upheld the receivership order. The Court confirmed that while more will be needed than simply the evidence required to obtain a freezing order, it was not essential that the Court see evidence that the defendant has breached or was about to breach the terms of the freezing order. The Court of Appeal accepted the statement in **National Australia Bank Limited v Bond Brewing Holdings Limited** by Robert Walker J (as he then was) to the effect that the appointment of a receiver was “an extraordinary and drastic remedy to be exercised with utmost care and caution and only when the court is satisfied that there is imminent danger of loss if not exercised”, provided that “imminent” means only “in the near future”.

Several factors influenced the court’s decision to grant a receiver in **JSC BTA v A**. First there was the court’s perception that the defendant was not willing to co-operate with regard to disclosure orders. Following the making of the freezing order, Mr A’s disclosure of assets was defective to the extent that Teare J found it necessary to order that Mr A be cross-examined. Teare J gave as an example of the defective disclosure the fact that Mr A had concealed his interest in the Eurasia Tower – a substantial structure in Moscow similar to Canary Wharf. The Court of Appeal noted that “an asset the size of Canary Wharf can hardly have slipped Mr A’s mind”.

Secondly, the opaque nature of the corporate structures in which the defendant’s assets were held (which Mr A said was explicable by the need to protect his assets from “unlawful depredations by the President of Kazakhstan”) and thirdly, the “measurable risk” that the structure might be used to deal with assets in breach of the receiving order. As the Court of Appeal put it:

“...if, therefore, a Freezing Order does not in itself provide adequate protection to a claimant because there is a measurable risk that a defendant may use the structure by which he holds his assets to deal with those assets in breach of the Freezing Order, then a receivership order will normally be justified.”

It may seem surprising that the court might appoint a receiver because there is a risk that a defendant may use a complicated corporate structure to breach a freezing order. It might be thought that there is a “measurable risk” of this in every case where a defendant has a complicated corporate structure. However, it is clear that a complex corporate structure will not be enough, on its own, to justify the making of a receivership order. This statement by the court has to be seen against the background of the defendant’s conduct after the freezing order had been made. Teare J, and the Court of Appeal, plainly felt that the evidence gave no grounds for confidence that the defendant would cooperate.

It is, of course, simplistic to suggest that simply because the appointment of a receiver is harmful to the defendant it is an advantage to the claimant. In our experience, it may be disadvantageous to both parties. Sometimes it is helpful when other jurisdictions are willing to recognise the receiver’s powers and title and to transfer assets to him. In
other situations, it can cause more problems than it solves. The cost to the claimant (he will usually have to indemnify the receiver for his own services and for the costs of his independent legal advice) is often considerable.

Further, once the receiver is appointed, questions will usually arise as to the extent which the claimant is himself entitled to information regarding the defendant’s assets in order to police the injunction. The point will be made that policing the injunction is the receiver’s job and not his.

Finally, the receiver may not proceed at a pace which the claimant – often desperate to get his money back – will approve of. From the receiver’s perspective, he is being inserted into hostile litigation and he will be concerned to ensure that he takes no steps that he may subsequently regret. From the claimant’s perspective, the paramount and often only concern is simply getting his money back.

The receiver is a masterstroke in some cases and a massive self-inflicted injury in others. The trick is to decide whether it is the right move for the case at hand.

Rory Cochrane

footnotes

1. It was faintly arguable that the court had this power previously: see Riches v Owen (1867-68) L. R. 3 Ch. App 820.
2. [2010] EWCA Civ 1141
3. [1991] VLR 386 at 541
Freezing orders: when can trust assets be frozen?

When a court grants a freezing injunction, its order will be based in large part upon the “standard form” freezing injunction wording. There are, however, two sets of standard form wording which a claimant can use. Depending upon which one is used, a claimant may be able to freeze a respondent’s assets even if the assets are held on trust for a third party. This issue and its implications for trustee respondents was considered in JSC BTA Bank v Kythreotis.

The standard wordings

Paragraph 5 of the standard form freezing order

“Until the return date or further order of the court, the Respondent must not remove from England and Wales or in any way dispose of, deal with or diminish the value of any of his assets which are in England and Wales up to the value of £X.”

What does “his assets” mean:

– under the Civil Procedure Rules Part 25 (paragraph 6 of PD25A)

“Paragraph 5 applies to all the Respondent’s assets whether or not they are in his own name whether they are solely or jointly owned. For the purpose of this order the Respondent’s assets include any asset which he has the power, directly or indirectly, to dispose of or deal with as if it were his own. The Respondent is to be regarded as having such power if a third party holds or controls the asset in accordance with his direct or indirect instructions.”

– under the Commercial Court Guide (paragraph 6 of CCG A5)

“Paragraph 5 applies to all the Respondent’s assets whether or not they are in his own name, whether they are solely or jointly owned [and whether the Respondent is interested in them legally, beneficially or otherwise]. For the purpose of this order the Respondent’s assets include any asset which he has the power, directly or indirectly, to dispose of or deal with as if it were his own. The Respondent is to be regarded as having such power if a third party holds or controls the asset in accordance with his direct or indirect instructions.”

When will it be appropriate to freeze Trust Assets?

The fundamental premise of a freezing injunction is that those who are alleged to have committed a fraud, or have knowingly received proceeds of a fraud, should not be entitled to dissipate funds which would otherwise be available to a successful claimant.

The Court’s jurisdiction to order a freezing injunction is exercised in a “flexible and adaptable manner.” Over time, the standard form wordings for freezing injunctions have developed to include mechanisms aimed at preventing a respondent from evading the effect of the order. For instance, the freezing injunction does not just prevent the respondent from dealing only with assets in his name; the respondent is also precluded from dealing with assets he holds jointly, and assets which he owns beneficially (ie even if the legal title to the asset is in another person’s name).

However, until recently, the standard form wordings did not provide complete protection to a claimant if a respondent established sham trusts. In a situation where a respondent held legal title to an asset, but did not beneficially own the asset, and the respondent maintained that he held the asset on trust for a third party who was not involved in the alleged fraud (a Trust Asset), a claimant would ordinarily not be entitled to freeze the Trust Asset. It is not uncommon for fraudsters to route the proceeds of their fraud through one or more offshore trusts: such a process can be tax effective and protects the confidentiality of the beneficiaries of the trust. It is therefore a small and easy step for a fraudster to try to defeat the purpose of any anticipated freezing injunction by setting up a trust where he is the trustee, and the beneficiaries are “innocent” third parties.

In Kythreotis, the Court of Appeal recognised the unsatisfactory position of the law and held that the new Commercial Court Guide wording entitled a claimant to freeze Trust Assets. This finding, which prioritises substance over form, is consistent with the approach taken in cases where there is a live issue as to whether someone who is effectively an innocent third party should be subject to a freezing injunction.
In this context, the courts have recognised that a third party can be subject to a freezing injunction even if the primary respondent to the freezing injunction has no legal or equitable right to the assets in question but has some right in respect of, or control over, the assets in question.8

The Court of Appeal did, however, emphasise that freezing Trust Assets should be done sparingly following careful consideration of the facts and circumstances of each case.9 The court stated that any claimant seeking to freeze Trust Assets should bear mind the following:10

- The finding did not alter the underlying principles which would justify the grant of a freezing injunction: the sole purpose of a freezing injunction is to prevent a respondent from dissipating assets which would otherwise be available to meet any judgment.
- Trust Assets should be the subject of a freezing order only if there are proper grounds to believe that those assets belong beneficially to a respondent to a freezing order, notwithstanding that they are ostensibly held by a respondent on trust or as nominee for a third party.

If Trust Assets are to be frozen, the impact of the order upon the apparent beneficial owner of the assets should be minimised. This would include:

- Extending the claimant’s cross-undertaking in damages to cover the beneficial owner of the Trust Assets where the injunction was subsequently varied or discharged in respect of the Trust Assets; and
- Hearing any challenge to the order by a beneficiary as to the beneficial title to the assets on an expedited basis.

The Kythreotis decision is good news for claimants who consider that their assets or funds which would otherwise be available to satisfy a judgment have been buried in sham trusts. However, it may come at too high a price for claimants given the likely scope of the cross undertaking in damages which they will need to provide.

Lucy Westwood

footnotes

1. One which is ordinarily applied in the Commercial Court (contained in Appendix 5 to the Commercial Court Guide (CCG A5)) and one usually applied in all other courts (contained in the Annex to Practice Direction 25A to the Civil Procedure Rules (PD25A)).
2. [2010] EWCA Civ 1436 (CA – Longmore, Aikens and Patten LJJ) (Kythreotis).
3. There is a slight variation in the wording depending upon whether a domestic or worldwide freezing injunction is sought but it is irrelevant to the present discussion. The text shown is applicable to freezing injunctions made over a respondent’s assets in England and Wales. Paragraph 5 of the standard wording is identical in PD25A and CCG A5.
5. Federal Bank of the Middle East v Hadkinson [2000] 1 WLR 1695 (Hadkinson). CCG A5 has now been amended to allow a claimant to freeze Trust Assets. However, PD25A has not been amended and therefore (per Hadkinson) does not entitle a claimant to freeze Trust Assets.
6. In Hadkinson at 1707, Mummery LJ referred to the submissions of Lawrence Cohen QC (lead counsel for the claimant bank in Hadkinson) regarding the potential for unscrupulous defendants to take advantage of the wording of the freezing order, to the detriment of a claimant, if it did not cover Trust Assets. This was described as a “powerful submission” in Kythreotis by Longmore LJ at [56].
7. Generally referred to as the exercise of “Chabra-type jurisdiction”, which is a reference to the finding in TSB Private Bank International SA v Chabra [1992] 1 WLR 231. In Chabra, the court held that subject to a claimant having a good arguable cause of action against one respondent, the court was entitled to grant a freezing injunction against another respondent against whom no cause of action lay, provided the injunction was “ancillary and incidental” to the cause of action against the main respondent.
8. As discussed in Dadourian Group International Inc v Azury [2006] EWHC 1768 (Ch) at [30], HM Revenue and Customers v Eggleton [2006] EWHC 2313 (Ch) at [41] and Yukos Capital Sarl v OJSC Rosneft Oil Company & Ors [2010] EWHC 784 (Comm) at [22].
9. Kythreotis at [48]. A similar comment is now made in the latest CCG A5 as a footnote to paragraph 6: “Whether this wider wording should be included in relation to the Order and/or the provision of information will be considered on a case by case basis – see generally JSC BTA Bank v Kythreotis”.
10. Kythreotis at [49].
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