Speedy cross-border debt recovery? The new Europe-wide freezing order

Key Features

What is an EAPO?

An EAPO is a procedural device available to creditors which will freeze some or all of the funds within any bank accounts held by a debtor which are located within the EU. ‘Bank account’ includes accounts containing cash or financial instruments. ‘Financial instruments’ includes transferable securities, options, futures, swaps and units in collective investment undertakings.

The EAPO regime applies to all pecuniary claims in all cross-border civil and commercial matters excluding arbitration and insolvency. Accordingly, any creditor can apply for an EAPO provided there is a cross-border element to the dispute. The wide definition of ‘cross-border’ may enable creditors to invoke the EAPO process in cases where the cross-border aspects of the matter are tenuous.

The new device is not intended to replace existing member states’ remedies available under national laws or art 31 of the Brussels Regulation. Nevertheless:

- It is not clear how the availability of an EAPO will weigh on a court’s discretion to grant a freezing injunction intended to have a similar effect.
- A creditor may want to obtain both an EAPO and a freezing injunction (for example, because the debtor has other assets than his bank accounts). In those cases, the two regimes will create overlapping and potentially conflicting obligations on the parties.

A creditor will be unable to freeze more than the amount of the debt in question.

When can a creditor apply for an EAPO?

A creditor can apply for an EAPO prior to or during the commencement of the creditor’s recovery action, or post-judgment as part of the enforcement process. In order to preserve the element of surprise, applications are made ex parte unless the creditor requests otherwise. In contrast to the usual position under English law, an ex parte applicant will not owe a duty of full and frank disclosure to ensure the court is aware of all relevant facts.

If the EAPO is sought before the creditor has a judgment against the debtor, the court must be satisfied that:

- the claim is ‘well founded’; and
- if the EAPO is not made, enforcement of the debt is likely to be impeded or made substantially more difficult, including because there is a real risk that the debtor might remove, dispose of or conceal assets in the bank account.

These are not likely to be high hurdles.

Further, where the creditor already has an enforceable judgment against the debtor, there are effectively no conditions to be met for the issue of an EAPO.

Does the creditor need details of the debtor’s bank account?

Unlike a freezing order, an EAPO does not give a creditor the right to obtain disclosure from the debtor of information relating to the debtor’s assets. Instead, the creditor can request that the member state in which the EAPO will be enforced obtain the bank details of the debtor. This is one of the more radical proposals in the Regulation, at least from the English perspective.

The Regulation proposes two options in relation to obtaining this information: either (i) enquiries can be made by the state of all banks in the member state to identify whether the debtor holds an account with them; or (ii) such information could be held on a central register. Some member states already have a central register under which all bank accounts within the state can be searched. England currently has no such register. At present, if a freezing order is granted the onus is on the applicant to contact each bank which it believes holds assets of the respondent to the freezing order.

The Regulation says nothing about how likely it must be that the debtor has a bank account in a particular member state before a creditor’s request to search for bank accounts there must be granted. Nor does it impose any prohibition upon the creditor using the information obtained for purposes other than the litigation for which it was sought.

On 25 July 2011, the European Commission released the proposed European Account Preservation Order Regulation, which has been submitted for consideration by the European Parliament and the Council of the EU. The UK government announced on 31 October 2011 that it will not opt in at this stage, but will participate in forthcoming negotiations relating to the Regulation with a view to opting in in the future.

The proposal introduces a new and additional kind of bank freezing order which is intended to be available throughout the EU. The order will be available to litigants in civil proceedings in appropriate circumstances. The proposal, if eventually adopted in the UK, will impose new requirements on the infrastructure of the court system and will materially change the way banks do business in relation to requests to search and freeze accounts. Given that it is intended to be available in the courts of any member state, it is reasonable to expect increased demands on banks in consequence.

KEY POINTS

- The UK government has chosen not to opt into the draft European Account Preservation Order (‘EAPO’) Regulation. However, the government will participate in the negotiations with a view to opting in at a later date.
- Considerable concerns have been raised about the limited nature of the debtor safeguards currently provided for in the draft Regulation.
- The number of EAPOs that banks are likely to have to implement is potentially very significant.
- An EAPO could constitute an event of default under a loan agreement.
How are third party accounts affected?
The Regulation defines ‘bank account’ as including accounts held ‘in the name of’ a third party on behalf of the defendant. A creditor is entitled to freeze, to the extent permitted by national law: (i) joint accounts; (ii) accounts held by a third party on behalf of the debtor; or (iii) accounts held by the debtor on behalf of a third party. It is common for accounts within categories (i) and (ii) to be frozen by an English freezing order, and in view of JSC BTA Bank v Kythreotis [2010] EWCA Civ 1436, it is likely that, in limited circumstances, the English courts will be prepared to freeze accounts falling within category (iii). However, there will be important distinctions in approach throughout member states.

In the event that a third party is prejudiced by the EAPO, it is entitled to object before the member state where the EAPO was issued or enforced.

In which state should a creditor apply?
A creditor has two options as to where it applies for an EAPO: either (i) in the same member state in which it is bringing its recovery action or (if judgment has been granted) it is enforcing the judgment; or (ii) where the bank account is located. Given that many aspects of the EAPO will be governed by national law, creditors might engage in forum shopping to determine which state will best serve the creditor’s objectives. In this regard, while the EAPO is aimed at creditors with a genuine debt claim, there will inevitably be a number of claims that are made with a view to exerting commercial pressure on a debtor.

How long will the process take?
The European Commission is anxious to ensure that the EAPO process is rapid. What some member states will regard as a very tight timetable has been laid down for applications:
- a pre-judgment EAPO must be issued within seven days of the application being filed. Where the EAPO is sought post judgment, it must be issued within three days of filing; and
- the bank must implement the EAPO immediately upon being served and within three days it must issue a declaration as to whether the account has been frozen and if so, to what extent.

How much will it cost?
The European Commission wishes to make the EAPO application process cost effective for small debts. Depending on national law, a creditor is likely to be liable for: (i) state search fees (if the bank account details are unknown); (ii) bank search or execution fees; and (iii) court fees.

Can the debtor challenge the order?
There is scope for a debtor to challenge an EAPO on certain specified grounds, either in the member state where the EAPO was issued, or where the EAPO will be enforced. If the debtor is a consumer, employee or insured, he will also have a right of challenge in his member state. Any challenge must be made within 45 days of the day the defendant was effectively acquainted with the contents of the order and was able to react.

Does the creditor have to provide security?
An applicant for an English freezing order is routinely required to provide an undertaking as to damages in respect of any loss which the respondent may suffer as a result of the order. With an EAPO, the court has discretion to order a creditor to provide a security deposit or equivalent assurance on account of any damage that might be suffered by the debtor.

Is the debtor entitled to living expenses?
Depending on the national law of the member state of enforcement, a creditor will not be entitled to freeze any amount necessary ‘to ensure the livelihood of the debtor and his family’ or, where the debtor is a company, to ‘ensure the possibility to pursue a normal course of business’.

In England and Wales, the court has discretion to allow a respondent to a freezing order to use a specific amount of funds for ordinary living expenses and to deal or dispose with assets in the ordinary and proper course of business. However, other member states’ policies as to the exemption of such amounts vary widely.

COMMENTARY
Views of financial industry practitioners and lawyers
A recent event held at Herbert Smith on 21 September 2011, by a panel comprising Roger Brown, Executive Director of Euro & Statistics, British Bankers’ Association, Steven Gee QC, Head of Stone Chambers, author of ‘Commercial Injunctions’, Sweet & Maxwell, Professor Doctor Burkhard Hess, Director, IPR Institute, University of Heidelberg, and expert to the European Commission in relation to the proposed EAPO and Eral Knight, International Directorate, Ministry of Justice gives some impression of the reaction of lawyers and the Financial Services Industry to the proposal.

The discussion was introduced by Robert Hunter, who served on a panel of experts to the European Commission in relation to proposals for the EAPO, and was chaired by The Hon. Mr Justice Michael Burton.

Following discussion at this event, the panel explored the likely effects the Regulation will have in different member states and the question of whether the UK should opt in to the Regulation. The event took place before the government’s announcement on 31 October 2011 that the UK would not opt in to the Regulation.

In addition to the panel discussion, opinion was sought from the audience, comprising lawyers and financial institution industry members, by way of interactive voting. At the outset of the evening, there was moderate support for the concept of the EAPO regime, with a vote on the question ‘Are you in favour of the draft Regulation in its current form?’ garnering 59 per cent support (with 53 per cent agreeing and 6 per cent strongly agreeing. Twenty-five per cent disagreed and 15 per cent strongly disagreed). By the end of the panel discussion however, the same question
revealed a very different result, with only 1 per cent strongly agreeing and 37 per cent agreeing. Thirty-five per cent disagreed and 27 per cent strongly disagreed.

**Likely effect on banks**
Traditionally, the significant cost of applying for a freezing order has effectively operated to limit the number of requests for banks to freeze accounts. If the UK eventually opts in to the regime, this landscape will change radically. The EAPO has been structured with a view to ensuring speedy, simple and cost effective cross border debt recovery by individuals and small businesses. The potential number of EAPOs which financial institutions may face is very significant.

Banks will be entitled to payment of their costs of responding to search requests or implementing EAPOs only where they are entitled to be paid under national law in relation to orders of equivalent effect. While the UK government would presumably introduce fixed fees for banks, it seems unlikely that this revenue stream would offset the banks’ costs of compliance, particularly given the resources which would be required in order to comply with the very short window within which banks must freeze the account and inform the creditor.

Once the EAPO attaches to a bank account, the bank is not permitted to withdraw or transfer funds from that account. In contrast to an English freezing order, which operates ‘in personam’ and has the effect of restraining a debtor’s conduct, the EAPO is intended to operate ‘in rem’ and the obligations attach only to the debtor’s property held by the bank. It is therefore not wholly clear what sanctions will result from a failure by a bank to comply with an EAPO.

In addition, the current drafting of the Regulation is likely to be problematic for banks. For example, where a bank holds a number of accounts of the debtor which are collectively in excess of the amount to be frozen by the EAPO, the surplus funds must be released by the bank to the debtor. The bank will therefore have to choose which surplus funds or accounts to release. The Regulation does not say how this choice is to be made and imposes no obligation on the bank to make the choice that is most advantageous to the creditor. There is therefore nothing to stop the bank freezing assets subject to a third party’s security, and releasing unencumbered funds to the debtor.

Finally, the Regulation says nothing about a bank’s right of set-off. In England and Wales, standard freezing orders expressly provide that they do not prevent the bank from exercising any right of set-off it may have in respect of any facility which it provided to the respondent before it was notified of the order.

**Debtor safeguards**
The Regulation seems to have been drafted with the purpose of making the process readily available to creditors. This has had the effect of ‘tail-loading’ the process, in the sense that an EAPO will be easy to obtain, with protection of the debtor’s rights coming at the point of challenge by the debtor. The application, which can be made electronically, will be made ex parte and the court has a very short time in which to grant the order after receiving the application. If the tests the court has to apply in order to grant the EAPO are met, the court has no discretion to refuse to grant the order. There will rarely be an oral hearing and even if the debtor finds out about the application, he does not have a right to be heard. The court, on receiving a challenge to an EAPO from the debtor, has a leisurely timetable in which to consider it.

In the meantime, the debtor’s accounts will have been frozen to potentially serious effect. Unlike a freezing order, an EAPO (even if subsequently found to have been wrongly granted) could constitute an event of default under a loan agreement. If loan agreements are not redrafted to take this into account, this will impose a heavy cost and risk on businesses of all sizes, which could well outweigh any overall benefits of the new regime.

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While the new regime will undoubtedly be of significant value to creditors seeking to recover cross-border debts, considerable concerns have been raised about the limited nature of the debtor safeguards currently provided for in the draft Regulation. At the Herbert Smith client event held on 21 September 2011, two questions on this subject were asked of the audience:
- Are you concerned that the Regulation provides insufficient protection for the interests of the creditor?
- Are you concerned that the Regulation provides insufficient protection for the debtor?

Of the voters on the first question, 15 per cent strongly agreed and 14 per cent agreed; 36 per cent disagreed and 35 per cent strongly disagreed. In relation to the second question, 66 per cent strongly agreed, 22 per cent agreed, and only 5 per cent disagreed and 7 per cent strongly disagreed. It seems that while people agree that the principle behind the draft Regulation is sound, they also feel strongly that there are insufficient debtor protections in the Regulation as currently drafted. This view seems to be shared by the UK government.