Fountain Court CHAMBERS

Quarterly Commercial Crime Newsletter:

COMMENTARY

"Navigating the uncertain boundary: two recent cases on commercial fraud in civil and criminal litigation"

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Introduction

Two recent appellate authorities - *AA v BB* [2021] 1 WLR 5378 and *Aquila Advisory Ltd v Faichney & Ors* [2021] UKSC 49 - provide an opportunity to consider the current landscape by which allegations of commercial fraud interact with, on the one hand, the various asset recovery remedies available to prosecuting bodies exercising a criminal jurisdiction, and, on the other hand, the remedies available to a civil litigant.

Whilst criminal proceedings and civil claims arising out of the same allegations of fraudulent conduct undoubtedly serve different functions, it is nonetheless appropriate to consider whether greater cooperation and early interaction between law enforcement agencies and those affected by commercial fraud will be to the ultimate benefit of all parties, including defendants. There is, at present, little effective joint case management between the two types of overlapping proceedings, which risks imposing challenges to prosecuting authorities in performing their functions, and at the same time, severe hardship to defendants when faced with the intrusive requirements of complying with overlapping orders made in two forums.

Civil freezing orders

The well-known description of the civil freezing injunction as "*one of the law's two nuclear weapons*" (*Bank Mellat v Nikpour* [1985] F.S.R. 87) reflects both the onerous requirements such an injunction imposes on a respondent, and the serious tactical advantage it can confer upon a litigant, at an early stage in a dispute. Whilst the requirements of good arguable case and real risk of dissipation need to be established, the reality is that in a complex commercial fraud, an applicant may have spent many months secretly preparing the application, and it is often very difficult for respondents to mount an effective challenge to the factual allegations upon which the application is based within the short timeframe stipulated for a response. As such, many respondents will have little choice but to elect either not to fight the freezing injunction, or to fight it on limited grounds, such as by contesting risk of dissipation only.

Ancillary asset tracing orders

The grant of a freezing injunction invariably carries with it a requirement to give disclosure of assets, and, where a proprietary claim is asserted, can also include far-reaching disclosure orders intended to assist the applicant in tracking down the assets over which the proprietary claim is asserted. Since the statutory abrogation of the privilege against self-incrimination in s.13(1) of the Fraud Act 2006, this means that a respondent to an ancillary asset tracing order in a freezing injunction case cannot avoid providing documents and information that will assist in locating assets, even where to do so would be incriminating. One area in which the consequences of this can be particularly acute is in bribery or secret profit cases, where orders can be made that (in effect) require the respondent to identify the bribes they allegedly received (even those currently unknown to the applicant), on the basis that, if the claimant's claim is well-founded, it will have a proprietary claim over those bribes (for examples of this see *International Fund for Agricultural Development v Jayzeri* (8th March 2002) and *BDW Trading Ltd v Fitzpatrick* [2015] EWHC 3490 (Ch)).

The exercise of complying with such an asset tracing order can be exceptionally onerous, often involving the respondent having to reconstruct transactions that occurred many years ago from historic documentation, under significant time pressure, whilst (assuming the order is made at the without notice hearing and compliance is not suspended pending the return date) at the same time mounting a defence to the freezing injunction application. Whilst the proportionality of the order is undoubtedly a point that can be taken by respondents, the authorities provide a neat riposte to this, in the principle that "*A court of equity has never hesitated to use the strongest powers to protect a trust fund*" (*Mediterrania Raffineria Siciliana S.p.A. v Mabanaft G.m.b.H.* (unreported, 1 December 1978 CA)).

However, it is not just the cost and inconvenience that potentially disadvantages defendants in this position. It is not the practice for the High Court to sit in private at return dates on freezing injunction applications, and as such, given that at a contested public return date hearing reference will almost inevitably be made to confidential information and documents comprising the respondents' asset disclosure and (in a proprietary case where ancillary tracing orders are sought) to information about what happened to disputed assets, the default position is that the (confidential) information

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and documents will become publicly known, irrespective of whether the challenge to the freezing injunction ultimately succeeds.

Where there are concurrent criminal proceedings whether in the UK or abroad, that publicity can therefore result in a collateral advantage to the prosecuting authority by way of furnishing it with confidential information from the defendant that it might not otherwise have been able to obtain in the course of the criminal investigation.

Interaction of criminal restraint orders and civil freezing orders

All of the above difficulties are compounded by the possibility that, concurrently with the civil freezing injunction proceedings, the prosecuting authority may take steps to seek similar relief in the form of a criminal restraint order (CRO), with a view to confiscating assets in due course following a criminal conviction.

For some time, it was at least arguable that the pre-existing grant of a CRO should preclude the grant of a civil freezing injunction, on the basis that, given the pre-existing restraint, the applicant cannot establish a real risk of dissipation of assets.

However, in the recent case of *AA v BB* [2021] 1 WLR 5378 the Court of Appeal decisively rejected such a proposition – at least as a presumptive starting point – holding that the existence of a CRO over all of the defendant’s assets was not a barrier to the grant of a civil freezing injunction. Whilst the Court of Appeal held that the relevance of a pre-existing CRO to the grant of a civil freezing injunction is fact-sensitive, the reasons given for why the CRO did not mean that there was no risk of dissipation included that, because of the different objectives of the prosecuting authority and the civil claimant, there was always a risk that the CRO would be varied or discharged without the civil claimant being able to adequately protect its position. As that risk is unlikely to be eliminated in any case - and the Court of Appeal noted the unlikelihood of this being ameliorated by effective joint case management between the criminal and civil proceedings - in practical terms, the prior existence of a CRO is unlikely to prevent a civil claimant from obtaining a freezing injunction in respect of the same assets.

The concurrent existence of two forms of restraint operating on the same individual defendant gives rise to various potential inconsistencies. To take several examples:

- Asset disclosure: whilst both the CRO and civil freezing injunction regimes provide the respective courts with powers to make ancillary disclosure orders to ensure the effectiveness of the two regimes, the orders are unlikely to be made in precisely the same terms, such that a defendant will be required to comply with two different asset disclosure exercises, imposing different requirements on the defendant and over potentially different timeframes.
- Living/legal expenses: both CROs and civil freezing injunctions usually contain allowances to permit the defendant to pay reasonable living and legal expenses out of the frozen assets. In the civil context, there is an important distinction between proprietary freezing injunctions and non-proprietary injunctions as to how such an allowance may operate. In the case of a proprietary freezing injunction, the defendant must first use any assets that are

not subject to the proprietary claim, and if there are no such assets, the Court conducts a balancing exercise to determine whether the frozen assets can be used at all, and if so, to what extent (see *Marino v FM Capital Partners Ltd* [2016] EWCA Civ 1301). By contrast, where there is a non-proprietary civil freezing injunction, the defendant is typically permitted to have an allowance for living expenses out of the frozen assets that is reflective of the defendant's ordinary level of expenditure. However, in a CRO context, a different approach is taken, in that the Court will seek to determine an objectively reasonable level of expenditure by reference to various criteria (see *R v Luckhurst* [2021] 1 WLR 1807 at [33]). A defendant facing both a civil freezing injunction and a CRO may thus find itself facing two different orders with different allowances for legal and living expenses and it may not be obvious how the two orders interact (in particular, as it is quite possible that the civil applicant for a freezing injunction would not have been aware of the existence of a CRO at the time of making the application, such that the discrepancy with an earlier order would not have been brought to the Court's attention).

- Cross-undertaking in damages: the grant of a civil freezing injunction is ordinarily conditional on the applicant giving a cross-undertaking to pay damages to compensate loss suffered if the injunction turns out to have been wrongly granted. There is, however, no equivalent cross-undertaking provided by the applicant for a CRO. Whether a claim by a respondent for damages under the civil cross-undertaking is possible in circumstances where the assets were restrained anyway by a CRO may give rise to difficult questions of causation.

Proprietary claims and challenges for prosecutors

So much for the challenges faced by defendants seeking to navigate these overlapping regimes. What then of prosecutors? Another recent decision throws the challenges faced by those acting on the other side into sharp relief.

In *Aquila Advisory Ltd v Faichney & Ors* (CPS intervening) [2021] UKSC 49, the Supreme Court held that a civil claimant with a proprietary claim over assets restrained under a CRO should be entitled to those assets in priority to criminal confiscation, notwithstanding that the civil claimant was the assignee of the company through which the fraud was conducted, and which was controlled by the convicted individual defendants.

The Supreme Court reached its decision by an application of the principles of attribution articulated in *Bilta (UK) Ltd v Nazir (No. 2)* [2016] AC 1, confirming that the principle by which a director's fraud was not to be attributed to a company so as to defeat the company's claim against the director for breach of fiduciary duty on illegality grounds, applied equally to a situation where the company was asserting a proprietary claim over secret profits which belonged to the company beneficially under a constructive trust. As the confiscation proceedings did not confer any proprietary rights on the CPS, the outcome was that the secret profits were not available for confiscation and ended up instead in the hands of the assignee of the company through which the fraud was conducted.

Notably, the Supreme Court was not attracted to the submission that that outcome was contrary to the purpose of the POCA 2002 regime, holding that POCA 2002 incorporated various mechanisms that the CPS could have deployed to protect its own claim to the assets, but failed to do so. The measures identified by the Supreme Court included:

- Indicting the company, securing a conviction against it, and then confiscating the assets in confiscation proceedings against the company itself.
- Civil recovery pursuant to Part 5 of POCA (albeit in that context a person asserting a proprietary claim may be able to obtain a declaration under s.281 POCA 2002 preventing the assets from being subject to civil recovery, if the requirements of that section can be met).

This decision therefore underlines the importance of early consideration by prosecuting authorities of the existence of any civil claims that have the potential to affect confiscation. Furthermore, given the difficulties in many cases for the relevant authority in mounting an effective prosecution against corporate entities for fraud, we may yet see greater use of civil recovery tools by prosecuting authorities.

Conclusion

The two authorities referred to in this article reflect the tensions inherent in overlapping regimes that serve different ends. Those tensions can risk negatively impacting all parties to criminal and civil proceedings if appropriate care is not taken to explore and anticipate this interaction. Practical steps that may be taken to avoid adverse outcomes could include:

- Early and pragmatic joint case management between criminal and civil proceedings where there are overlapping restraint orders and freezing injunctions, to avoid inconsistent regimes and prejudice to defendants.
- From the perspective of prosecuting authorities, early consideration of whether there might be the potential for a civil proprietary claim over the wrongdoers' gain from the fraud, so as to assist and inform decisions as to whether to bring criminal charges against companies or to commence civil recovery proceedings instead.
- From the perspective of defendants, ensure that concurrent advice is sought about how to mitigate the potential impact of both civil freezing injunctions and CROs on living and legal expense allowances and onerous asset disclosure, which will necessarily involve having regard to both regimes.

Fountain Court Counsel acted in each of the two authorities referred to in this article.

In AA v BB [2021] 1 WLR 5378, Charles Béar QC and Laura John QC acted for the appellants.

In Aquila Advisory Ltd v Faichney & Ors (CPS intervening) [2021] UKSC 49, Stuart Ritchie QC acted for the respondent.

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Tamara is a high-profile practitioner with a broad commercial and civil practice and is described in the directories as "*ferociously clever*" and "*a true role model for the commercial Bar*". Tamara has been instructed on a number of high-profile corporate crime cases (and / or cases with an investigatory element) and is often sought after to advise on privilege and confidentiality issues in that context.

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