

legal update

YOUR UPDATE OF
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COMMERCIAL LAW

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Non-disclosure – managing the fall-out

Every litigator knows that an applicant on a without notice application, typically a freezing injunction or a search and seizure order, must make full and frank disclosure of all relevant information at the time of the application.

But what is the extent of that duty, and what options are available to a party who has failed to discharge the duty?

The duty

An applicant must disclose to the court all matters that are relevant, ie material for the court to take into account in deciding whether to grant relief, and if so on what terms. The application must be presented fairly and in practice this means that the duty applies not just to disclosure of facts but to absolutely anything which the judge should consider. The applicant's lawyers must be astute to identify legal arguments contrary to the applicant's case. It is not enough simply to place relevant documents before the court, for example in an exhibit: it is for the applicant to identify the crucial points for and against the application.

Relevance is construed widely: if a fact situation has a nexus with the proceedings or the application, then it is probably relevant. The ambit of relevance extends beyond the merits of the claim or the defence: see, for example *St Merryn Meat Ltd v Hawkins* (Lawtel, 29 June 2001) where a Mareva injunction was discharged and not re-granted, despite admissions of fraud by the defendants, on the grounds that the applicants had failed to

disclose that evidence used on the application had been obtained illegally and they had later deliberately misled the court as to the source of that evidence.

The duty extends beyond facts within the applicant's knowledge to facts that could have been ascertained by all the inquiries which should reasonably have been made. Further, the test of materiality is an objective one and it is no excuse for the applicant to say later that he was genuinely unaware, or did not believe, that the facts were relevant or important.

Non-disclosure and its consequences

At one time any material non-disclosure would lead to the discharge of the injunction, usually without the grant of a new injunction. There have been signs of a moderation of this approach, particularly since the advent of the CPR and the overriding objective. This shift is perhaps best seen in *The Arena Corporation Ltd v Schroeder* [2003] EWHC 1089 (Ch) in which the court reviewed the relevant authorities and summarised the main principles which should guide it in the exercise of its discretion to discharge or re-grant an injunction as follows:

- > If the court finds that there have been breaches of the duty of full and frank disclosure on the application without notice, the general rule is that it should discharge the order obtained in breach and refuse to renew the order until trial.
- > Despite the general rule, the court has jurisdiction to continue or re-grant the order.
- > That jurisdiction should be exercised sparingly, and should take account of the need to protect the administration of justice and uphold the public interest in requiring full and frank disclosure.
- > The court should assess the degree and extent of the culpability for the non-disclosure. It is relevant that the breach was innocent, but there is no general rule that an innocent breach will avoid a discharge of the order. Equally, there is no general rule that a deliberate breach will attract that sanction.
- > The court should assess the importance and significance to the outcome of the application for an injunction of the matters which were not

disclosed to the court. In making this assessment, the fact that the judge might have made the order anyway is of little if any importance.

- > The court can weigh the merits of the claimant's claim, but should not conduct a simple balancing exercise in which the strength of the claimant's case is allowed to undermine the policy objective of the principle.
- > The application of the principle should not be carried to extreme lengths or be allowed to become the instrument of injustice.
- > The jurisdiction is penal in nature and the court should therefore have regard to the proportionality between the punishment and the offence.
- > There are no hard and fast rules as to whether the discretion to continue or re-grant the order should be exercised, and the court should take into account all relevant circumstances.

The court retains a broad discretion, notwithstanding that there has been material non-disclosure, to continue or re-grant a freezing injunction. Even serious cases of non-disclosure will not necessarily lead to discharge.

Case study - *SITA v Serruys*

In *Sita UK Group Holdings Ltd v Serruys* [2010] EWHC 698 (QB), C alleged that D had induced a contract for the sale of a company, E, by fraudulent pre-contract representations, concealing a number of allegedly dishonest practices by E which supported its profitability. The allegations both of misrepresentation and of the underlying dishonesty were strenuously denied. C operated E as a stand-alone business with its own senior management. C obtained a worldwide freezing injunction against D on a without notice application. On that application it was part of C's case that it would never countenance dishonesty in its business and that it would not have purchased E had it known of the dishonest practices. Unknown to the directors of C, however, after the acquisition of E the business had continued one of the allegedly dishonest practices up to and beyond the without notice application.

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If in doubt, disclose



That fact was not disclosed to the court. On discovering the true facts and on advice, the directors of C immediately made an application to bring the matter before the court for the purposes of making full disclosure and seeking the continuation or re-grant of the injunction. C also took immediate and drastic steps to end the dishonest practices and to remove the senior management that had either allowed those practices to continue or failed to identify and stop them.

The court found that even though the directors of C had no knowledge of the continuing dishonest practices, E's senior management did. It further held that that knowledge was attributable to C and, since the senior management had been instrumental in providing information for the freezing injunction application, the non-disclosure was deliberate but not motivated by any desire to obtain a forensic advantage. In continuing the freezing injunction, but imposing a substantial costs sanction on C, the judge had particular regard to the admonitions in *The Arena Corporation* that the principle that a without notice injunction may be discharged for non-disclosure should not be carried to extreme lengths or be allowed to become an instrument of injustice, and that the jurisdiction is penal in nature and the court should therefore have regard to the proportionality between the punishment and the offence. The judge found that C had a good arguable case and that there was a real risk of dissipation if the freezing injunction was not continued. His role was to balance the competing aims of punishing non-disclosure and doing justice between the parties. A significant factor was that C had acted reasonably and not oppressively in policing the freezing injunction.

Practical tips

Obviously, the best tip is to avoid non-disclosure. However, it is a fact of life that large corporates, in particular, frequently have long and inefficient lines of communication between head office and operations. In such cases, the duty to make enquiry cannot be over-emphasised. Lawyers will serve their clients well by asking searching and uncomfortable questions and ensuring that those questions are addressed to managers who are likely to know the answer. A response from the CEO that 'We would never do that sort of thing' will not afford any protection when it subsequently transpires that an outpost of the company did just that sort of thing, albeit unknown to the CEO, if the question was not addressed to managers who would know.

If non-disclosure does come to light, the applicant should act quickly and decisively to bring it to the attention of the court and to put its house in order. An applicant who brings the non-disclosure to the attention of the court of its own volition will have the advantage of being seen to be acting responsibly and to be putting its duty to the court above its own short-term interests. It is a mistake to wait for the other side to make an application. Legal advisers should be cautious in assessing the materiality of new facts, as this exercise is one which should be carried out by the court. If in doubt, disclose.

David Fisher has a general commercial practice and has extensive experience of commercial fraud. Nicola Allsop has a modern chancery commercial practice with particular emphasis on insolvency and company-related litigation. Both were members of the team that helped SITA to identify and deal with the non-disclosure. The case subsequently settled at trial.

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E-mails and pre-action third party disclosure

For purposes of disclosure, r 31.4 of the CPR defines a document (in very broad terms) as "anything in which information of any description is recorded". Practice Direction 31B – Disclosure of Electronic Documents specifically provides (para 5(3)) that an electronic document "includes e-mail and ... documents that are stored on servers and back-up systems and documents that have been deleted. It also includes Metadata and other embedded data which is not typically visible on screen or a print out."

Value of e-mail evidence

In fraud and tracing claims, e-mail communications often constitute important evidence which may be the most damning in content. Although wrongdoers are becoming increasingly aware of the trail left behind by electronic communications, it is still true that e-mails (including 'deleted' e-mails) often provide a rich vein of probative evidence which can assist claimants in identifying wrongdoers and potential defendants, as well as in tracing the flow of misappropriated funds. Because of the more informal (and instant) nature of e-mail communications, when sending or responding to an e-mail individuals may make unguarded or ill-advised comments which they would not do if they were composing, proofing and sending a formal letter.

Moreover, many transactions today (particularly urgent transactions) are conducted by e-mail. For example, e-mail may be used for giving instructions to solicitors to effect transactions or payments, or to banks to make urgent transfers between accounts. When time is of the essence (which it often is for wrongdoers who are distributing or dissipating misappropriated assets) resort is frequently had to e-mail.

Another important feature of the e-mail is that it is very easy for the sender to copy his or her e-mail to a number of interested parties. It is this ease of circulation which can sometimes have the unintended effect of enabling claimants to identify co-conspirators or recipients of misappropriated moneys.

The working assumption for any claimant in a proposed fraud action must be that the alleged fraudster will not comply with his obligation to make proper disclosure, if that would entail incriminating himself or his associates, or providing information which would enable identification of the proceeds of his fraud, or the location of his assets. Accordingly, it will often be necessary to consider other means of obtaining reliable information. The most reliable source of e-mail communications will be innocent third parties, although they will generally be able to disclose only a selection of relevant e-mails (ie those sent or received by them). But an exception to that limitation is the internet or e-mail service provider. The service provider will have access to all of the e-mails (and attachments) sent or received by the fraudster rather than merely



... compel the defendant's e-mail service provider to disclose documents ...



those passing between two parties. Moreover, the service provider may well have retained copies of deleted e-mails which would no longer feature in its customer's Inbox. The value of trying to compel the defendant's e-mail service provider to disclose documents and related metadata should not be overlooked.

Remember that when seeking copies of e-mails, the embedded data can also be requested. Metadata can provide valuable information about documents on such matters as the author and the precise location of the sender of an e-mail, and the precise date and time an e-mail or an attachment to an e-mail was read. Such information may constitute important evidence.

Third party disclosure before commencing proceedings

Probably the most common means of obtaining orders for third party disclosure (pre-action) is by applying for a *Norwich Pharmacal* order, or in the case of a proprietary or tracing claim, a *Bankers Trust* order. A person innocently caught up in the wrongdoing of another (more than a mere witness) can be compelled under the *Norwich Pharmacal* jurisdiction to disclose the identity of the wrongdoer, so that proceedings may be brought against the proper defendant. To found the exercise of discretion, a wrong must, at least arguably, have been committed and the innocent third party must be likely to be able to provide information necessary to identify a wrongdoer. A *Bankers Trust* order for disclosure of documents from a third party may be obtained in support of a proprietary claim, so as to assist the claimant in tracing his assets. It is now well established that *Norwich Pharmacal* relief is not limited to the disclosure of information designed to identify a wrongdoer but is a flexible remedy which may be available where the court considers it to be necessary in the interests of justice: *R v Secretary of State, ex p Binyam Mohammed* [2008] EWHC 2048 (paras 132-134). In *Aoot Kalmneft v Denton Wilde Sapte* [2002] 1 Lloyd's Rep 417 (para 17) the court held that the principle extended beyond simply identifying the wrongdoer to identifying him as a wrongdoer (ie whether or not any wrongdoing took place).

An e-mail service provider whose e-mail system is used to arrange or further a fraud or transfer of assets in breach of trust or fiduciary duty is highly likely to be in possession of disclosable

documents and is in a classic position of a party who is innocently caught up in the wrongdoing of another.

It appears that a degree of flexibility will also apply to *Bankers Trust* orders, although their focus is specifically on tracing the whereabouts of the claimant's assets. It is clear though that, depending upon the particular facts, the courts will be astute to assist a claimant to trace his own property by ordering appropriately broad disclosure. The key issue is whether there is a real prospect that the documentation sought may lead to the location or preservation of the claimant's assets. Any claimant ought, with as much specificity as possible, identify the documents or information wanted in order to maximise the chances of a obtaining the order sought.

If the claimant has obtained or is in the process of obtaining a freezing injunction, an alternative means of securing an order for disclosure is by relying on s 37 of the Senior Courts Act 1981, which enables the court to make an order ancillary to a freezing injunction so as to ensure that its injunction is not frustrated.

In all such cases, because an e-mail service provider is a 'data controller', the courts will need to consider the provisions of the Data Protection Act 1998 and in particular the rights and freedoms and the legitimate interests of the potential defendant (the 'data subject') as well as the legitimate interests of the claimant. The potential defendant's rights under article 8 of the ECHR (right to respect for private life) will also need to be considered. According to article 8(2), however, such rights must be balanced against the interests of the prevention of crime and the protection of the rights and freedoms of others. It is clear that in an appropriate case, and provided that the order would not *unjustifiably* interfere with the rights of the potential defendant, the courts will be prepared to make disclosure orders against e-mail service providers.

Nigel Hood has a broad-based commercial chancery practice but specialises in cases (for both claimants and defendants) involving fraud, dishonesty and misfeasance in a range of activities, including those of company directors, trustees, accountants and lawyers.

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Making freezing orders bite

"International fraud is nowadays of increasing concern in the international community. If anything it has grown in recent years."
So said Longmore LJ in *JSC BTA Bank v Kythreotis* [2011] 1 WLR 888, a recent decision of the Court of Appeal.

The nub was whether a respondent should be permitted, on receipt of a freezing order, to say to himself that as such and such assets were held by him on trust for another, he need not inform the applicant about them and he could deal with those assets as if the order had not been made. When the court was faced with a respondent who, it had already found, was likely to dissipate assets to prevent enforcement of a judgment, the Bank contended that the right answer to that question was no. The Court of Appeal reluctantly agreed.

Jurisdiction to freeze assets pre-judgment

The jurisdiction to grant a freezing order is one which was born out of judicial development of the common law and continues to be developed to respond to the commercial and practical needs of parties. As Lord Donaldson MR observed in *Derby & Co Ltd v Weldon* [1990] Ch 65 at 77:

"We live in a time of rapidly growing commercial and financial sophistication and it behoves the courts to adapt their practices to meet the current wiles of those respondents who are prepared to devote as much energy to making themselves immune to the court's orders as to resisting the making of such orders on the merits of their case."

It is well established that the purpose of a freezing injunction is to preserve assets so that enforcement of a (prospective) judgment can take effect, and it would be wrong to allow a respondent himself to certify that a particular asset

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is outside the order by asserting that he holds the asset for a third party. The respondent *ex hypothesi* is not someone whom the court believes it can trust not to dissipate his assets pending trial.

The development of standard forms

The first standard form freezing injunction was issued by way of Practice Direction in 1994. The aim was to standardise the wording and interpretation of the orders granted. A significant change was introduced: assets held jointly with someone who was not a respondent were captured (even though the beneficial interest of the respondent might be held under a joint tenancy or the respondent's beneficial interest might amount only to a small proportion of that jointly-owned asset).

In July 2002 a precedent under CPR Part 25 introduced a new paragraph 6 elaborating the meaning of "assets" for the purposes of the injunction:

"Paragraph 5 applies to all the Respondent's assets whether or not they are in his own name and 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." (Emphasis added.)

This change appeared to follow the decision of the Court of Appeal in *Federal Bank of the Middle East v Hadkinson* [2000] 1 WLR 1695, in which Nourse LJ had observed, at 1715:

"It may be that the standard form of freezing order is one of imperfect operation. But, unless and until it includes the words 'and whether held for his own benefit or for the benefit of others' or the like, the imperfections will persist."

However, the precedent in the *Commercial Court Guide* (8th edition, 2009) suggested different additional wording to paragraph 6: "Paragraph 5

applies to all the Respondent's assets whether or not they are in his own name and whether they are solely or jointly owned and whether the Respondent is interested in them legally, beneficially or otherwise".

The *Kythreotis* decision

The Court of Appeal held that in the Commercial Court precedent the juxtaposition of "*legally*" and "*beneficially*", separated by a comma, indicated that those two different forms of ownership were independent of one another. As Patten LJ observed, at [46]:

"... [T]he words are disjunctive. ... If the new words were intended only to confirm that the order includes assets held by the defendant legally (and beneficially) as well as only beneficially then they were unnecessary because the opening words of paragraph 6 ('whether or not they are in its own name') have precisely that effect. Any assets owned both legally and beneficially will be held by the defendant in his own name. Therefore ... I can only conclude that paragraph 6 effects an expansion of the type of asset which paragraph 5 of the order would otherwise include. Assets held by the defendant as a trustee or nominee for a third party are included by an order which contains the new words."

Thus a respondent who holds certain assets beneficially and others on trust for third parties will have all of these assets frozen if the Commercial Court Guide wording is adopted in the freezing injunction. The respondent will also have to give disclosure about both categories of assets.

Did the Court of Appeal go too far?

This expansion should not come as a surprise given the increasingly broad approach to assets vulnerable to a freezing injunction evident from cases such as *C Inc plc v L* [2001] 2 AER (Comm) 446.

Secondly, a personal freezing injunction (as distinct from a proprietary freezing injunction) offers relief *in personam* only; it does not offer

any security to the applicant and does not confer any proprietary rights. The construction approved by the Court of Appeal is consistent with that and the ability of the respondent or an interested third party to apply to vary the injunction, at any stage, remains.

Thirdly, the disclosures made by respondents to freezing injunctions need not necessarily enter the public domain. Steps can be taken to maintain the confidentiality of such disclosures, for example by restricting the recipients of the disclosures. Further protection is offered by CPR r 31.22 and the standard form undertaking about use of documents.

Fourthly, there is the standard undertaking in damages which an applicant must give. And finally, there is the *Angel Bell* provision which enables a respondent to continue to carry on his ordinary business in the same manner as before the injunction was granted, provided he notifies the applicant in advance: see *Atlas Maritime Co SA v Avalon Maritime Ltd (No 1)* [1991] 1 Lloyd's Rep 563.

The Court of Appeal's decision does not have the consequence that trust assets will remain frozen forever. But in an appropriate case that merits the wider form of freezing injunction, it does have the consequence that trust assets may only be dealt with either in the ordinary course of the business of the trust (after notification), or with the blessing of the court or the consent of the applicant.

Emily Gillett has a broad commercial chancery practice and was listed as one of 10 'Stars at the Bar' by *Legal Week* in October 2010. She is involved in the large BTA litigation and was led by Stephen Smith QC of these chambers in *Kythreotis*.

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