Corporate fraud, investigations and asset recovery update  

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Contents

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Damages for loss of chance to profit from trading strategy</td>
<td>8</td>
</tr>
<tr>
<td>The Bribery Act: Commentary on the new offences</td>
<td>12</td>
</tr>
<tr>
<td>The House of Lords sets aside order for examination of foreign officer of judgment debtor</td>
<td>17</td>
</tr>
<tr>
<td>Recent developments on Norwich Pharmacal jurisdiction</td>
<td>18</td>
</tr>
<tr>
<td>Contributory negligence and contribution in cases of deceit</td>
<td>21</td>
</tr>
<tr>
<td>Court of Appeal brands privilege against self-incrimination a “fraudster’s refuge”</td>
<td>23</td>
</tr>
<tr>
<td>The difficulty of establishing unlawful means conspiracy</td>
<td>26</td>
</tr>
</tbody>
</table>
Editorial

Welcome to our Corporate fraud, investigations and asset recovery update, encompassing some of the most important civil fraud decisions from 2009, and new developments from 2010.

As widely predicted in the press, the economic downturn has continued to provide corporate fraud practitioners with a steady flow of instructions, and ever more ingenious schemes for the courts to analyse.

A recent survey by the Financial Times found that fraud is now costing the United Kingdom alone almost £2.1 billion annually. Whilst not all of this can be attributed to corporate fraud, a further recent survey in the Daily Telegraph highlighted that the average value of each fraud committed is now in excess of £5 million, compared with £1.8 million in 2003. This demonstrates that fraud remains big business and a big concern for business, particularly during the downturn.

Against this background, I am therefore pleased to welcome Robert Hunter to Herbert Smith. Robert joined me in September 2009 as joint head of our corporate fraud and asset tracing practice, and is widely acknowledged as one of the UK’s most highly respected lawyers in this area. He has conducted some of the largest fraud cases to come before the English courts and will complement our practice greatly.

This edition of the briefing considers the following cases of note from 2009:

• One of the final decisions of the House of Lords, considering auditors’ liability in the context of failing to detect a corporate fraud. The case is of great interest because it overturns a decision of the Court of Appeal concerning the *ex turpi causa* defence, discussed in our last briefing.

• A key decision of the High Court in the context of damages arising from a deceit claim. Although arising from unusual facts, it shows the potential extent of such damages.

• An analysis of the provisions of the Bribery Act.

• A House of Lords decision concerning the English Court’s ability to examine a foreign officer of a judgment debtor.

• A significant and welcome High Court judgment concerning *Norwich Pharmacal relief*, which clarifies and restores the bounds of the Court’s jurisdiction in this field.

• An analysis of a High Court decision concerning contributory negligence in cases of deceit.

• A stinging rebuke of an alleged fraudster’s attempt to rely on the privilege against self-incrimination by the Court of Appeal.

• A decision of the High Court showing the difficulty of establishing knowledge in the context of unlawful means conspiracy.

We are, as ever, happy to discuss any of the cases discussed in this edition and how they might impact on your practice or business.

Simon Bushell
Auditors’ liability in fraud cases: House of Lords rules in *Moore Stephens v. Stone & Rolls Limited*

In a decision handed down just before the end of term, auditors have won an important House of Lords ruling limiting their liability in cases where a “one man” company is used as a vehicle for fraud. The Law Lords dismissed by a majority of three to two a negligence claim brought against an audit firm for failing to detect a massive fraud at Stone & Rolls, a trading company that fell in the late 1990s – holding that the liquidators could not bring a claim for damages when the company itself was responsible for the fraud.

**Background**

The liquidator acting on behalf of Stone & Rolls Limited (the “Company”) brought proceedings in the Commercial Court in December 2006 against Moore Stephens (the “Auditors”) claiming that they had been negligent in conducting the Company’s audits in the years 1996, 1997 and 1998.

In particular, the Company alleged that the Auditors had breached their duty to act with reasonable skill and care in failing to detect and report to regulators a fraudulent scheme which was being perpetuated by Mr Zvonko Stojivic (“Mr Stojivic”) using the Company as his vehicle. Had the auditors fulfilled their duty, it was said, the fraud would have been revealed and stopped. The fraud involved the Company obtaining payments under letters of credit by presenting to banks false documents in relation to fictitious commodity trading. The monies fraudulently obtained were subsequently taken out of the Company and passed to other participants in the scheme.

When one of the banks upon whom the fraud had been perpetrated sued the Company and Mr Stojivic in deceit, that bank was awarded substantial damages. However, the bank was unable to recover anything from Mr Stojivic and the Company was insolvent. As a result the Company went into liquidation and the liquidator brought the present claim against the auditors in an attempt to recover damages of almost US$174 million.

The Auditors sought summary judgment on, alternatively a strike out of, the Company’s claim on the basis that, even if they had been negligent (which they accepted for the purpose of the application) they had a complete defence based upon the public policy principle that a party in bringing a claim was not allowed to rely upon its own illegal behaviour (*ex turpi causa non oritur actio* (*“ex turpi”*)).

**The decisions of the Courts below**

**The parties’ legal arguments**

In support of the application, the defendant Auditors relied upon the fact that Mr Stojivic was the sole “controlling mind and will” of the Company, which was said to be a “one-man band”. Thus, Mr Stojivic’s fraud was the Company’s fraud and the Company could not rely upon that fraud when bringing its claim against the Auditors. The Company was, the argument ran, barred from its claim by the operation of the *ex turpi* maxim.

In response, the Company sought to rely upon the principle in *Re Hampshire Land Co* [1896] 2 Ch 743, that where an officer or employee of a company commits a fraud upon the company itself then the knowledge of his own fraud is not the knowledge of the company. In *Belmont Finance v Williams Furniture* [1979] 1 Ch 250, the principle was put in terms that knowledge should not be attributed to the company where the company was the “victim” of the improper conduct of its officers. The Company further argued that, in any case, the *ex turpi* maxim did not provide a defence as the fraud was the “very thing” that the Auditors owed a duty to prevent.

**The Commercial Court’s decision**

The application came before Langley J who gave Judgment on 27 July 2007 ([2007] EWHC 1826 (Comm); [2008] Bus LR 304): see our e-bulletin dated 17 September 2007 (please let us know if you would like to receive a copy).

Langley J observed that the claim could not have been brought by Mr Stojivic himself, nor by his trustee in bankruptcy, and on the normal rules of attribution Mr Stojivic’s knowledge and wrongdoing was to be attributed to the Company as he was its “directing mind and will”. He found that the Hampshire Land exception did not apply because the Company lost nothing to
The decision in the Court of Appeal

Lord Justice Rimer, with whom Mummery and Keene LJJ agreed, gave the decision of the Court of Appeal on 18 June 2008 [2008] EWCA Civ 644; [2008] 3 WLR 1149.

The Court of Appeal broadly approved the reasoning of Langley J on the attribution issue. In particular, the Court of Appeal concluded that the Company “was itself the fraudster...Not the target of the fraud.”

Turning to the “very thing” argument, Rimer LJ said it could not trump the ex turpi rule, which he described as “unforgiving and uncompromising”. He said that the House of Lords’ exposition of that rule in Tinsley v Milligan [1994] 1 AC 340 admitted of “no discretion in the matter”.

As such, the appeal was allowed and the claim was struck out.

The judgment of the House of Lords

The Lords of Appeal delivered their Opinions on 30 July 2009 [2009] UKHL 39; [2009] WL 20207450. By a majority of three to two (Lord Scott and Lord Mance dissenting), the House upheld the decision of the Court of Appeal and dismissed the Company’s appeal.

Lord Phillips delivered the first Opinion. He found that the fraud was properly attributable to the Company as “Where those managing the company are using it as a vehicle for fraud, or where there is only one person managing all aspects of the company’s activities, there is no difficulty in identifying the fraud as the fraud of the company”, i.e., there was no room for the application of the Hampshire Land exception in such circumstances. He indicated that he might have seen the point differently if there had been independent shareholders that had been “hijacked” by Mr Stojcic. In his view, the critical difference of opinion between the majority and the minority in this case was that the minority considered that the interests that the auditors undertook to protect included the interests of creditors. Whilst it was, in his view, arguable that the scope of the duty undertaken by the auditors of a company should extend to protecting the interest that the creditors have in the preservation of the assets of the company (which, he said, would require an extension of the principle in Caparo Industries plc v Dickman [1990] 2 AC 605), in this case all those whose interests formed the subject of the Auditors’ duty of care to the Company, namely the Company’s sole will and mind and beneficial owner Mr Stojcic, were party to the illegal conduct that formed the basis of the Company’s claim and in those circumstances ex turpi provided a defence: “it is very difficult to see how the law can rationally hold an auditor liable when the entire shareholder body and the entire management is embodied in a single individual who knows everything because he has done everything”.

Lords Walker and Brown concurred with Lord Phillips, though, as the latter himself noted, they restricted their reasoning to the situation where the directing mind and will of the company was also its owner. Lord Walker said the Hampshire Land principle was akin to the US “adverse interest” exception to the normal rule of imputation, and that there was in turn a “sole actor” exception to the “adverse interest” exception. In his view, the “sole actor” principle applied where there was one single dominant director and shareholder, even if there were other directors or shareholders who were subservient to the dominant personality, or where there were two or more individual directors and shareholders acting closely in concert. He therefore concluded that individuals who for fraudulent purposes ran a “one-man” company (in the sense which he described) could not obtain an advantage by claiming that the company was not a fraudster but a secondary victim. He accepted that the situation of innocent shareholders “hijacked” by a fraudulent but dominant director would raise “difficult questions” as to which one would need to look closely into the facts in order to see whether it would be contrary to justice and common sense to treat the company as complicit. Lord Brown likewise confined the ex turpi defence in such circumstances to “one man company frauds” meaning that “where any innocent shareholders are involved, a claim against the auditors may well lie (through the company) at their suit”: this could be for the innocent shareholders’ own
loss suffered through the continuing fraud from the time when, following a diligent audit, it should have been uncovered and brought to an end.

Lord Scott said he found this “a very difficult case”. In his view, the matter was not suitable for a strike out because, although the majority had proceeded on the basis that Mr Stojivic was the beneficial owner of the shares in the company, it appeared that he held indirectly through his family trust and a company incorporated in the Isle of Man. There were no factual findings as to ownership and it would be a matter for trial whether Mr Stojivic was in fact the absolute beneficial owner of the shares in the Company.

Lord Scott pointed out that Mr Stojovic, who was not a director, had acted pursuant to a power of attorney which could not have extended so as lawfully to authorise him to use the Company as a vehicle for defrauding the banks: everything done by the Company at the direction of Mr Stojovic and in pursuance of his fraudulent scheme must have been ultra vires his powers under the power of attorney, which meant that the company was a victim of his fraudulent scheme. Lord Scott pointed out that there was no case in which the “sole actor” exception to the Hampshire Land principle had been applied to bar an action by a company against an officer (the auditor also being an officer for the purposes of, for example, a misfeasance claim under section 212 of the Insolvency Act 1986) for breaches of duty that had caused or contributed to loss to the company as a result of the company engaging in illegal activities. He said that Mr Stojovic would not be able to avoid a section 212 misfeasance claim by invoking the ex turpi rule and the “sole actor” principle, and the Auditors should be in no different position.

Lord Scott also drew a distinction between a cause of action in negligence brought by a solvent company, where any damages recovered would be for the benefit of the shareholders, and a similar cause of action brought by an insolvent company, where damages would benefit creditors. Where a solvent company suffered loss as a result of unlawful activity directed by a director who was also a shareholder, loss which should have been avoided if the auditors had reported properly, the ex turpi rule could not bar the company’s claim against the director and the auditors and the action, if successful, would via contribution proceedings leave the delinquent director (qua shareholder) no better off. Where, as here, the company was insolvent, no such complication would arise, there would be no prospect of Mr Stojovic recovering anything and there was therefore no reason of public policy where ex turpi should bar the claim.

Lord Mance focused on the separation of legal personality as between the Company and Mr Stojovic. He said a claim by the Company against Mr Stojovic would not be barred in the ex turpi rule. Likewise, it was “clear beyond doubt” that a company could sue its auditors for negligent failure to detect and report fraud by a company’s directing mind where (at the very least) the company had innocent shareholders. However, he added that there was no authority for the proposition that the Hampshire Land principle only applied where there was an “innocent constituency” of officers/sharholders to whom knowledge of the fraud could have been (but was not) communicated.

In Lord Mance’s view, the fraud here was a fraud on the Company and he said there were many authorities dealing, first, with the defrauding of third parties and then with the stripping from the company of its resulting assets obtained for the benefit of the directing minds and beneficial owners. In those cases, the company was seen as the victim in the action by the company. As a matter of English law, therefore, it was no answer to the claim to say that Mr Stojovic was the company’s sole directing mind and sole shareholder.

Lord Mance said an auditor could not, by reference to the ex turpi rule, defeat a claim for breach of duty in failing to detect managerial fraud at the company’s highest level by attributing to the company the very fraud which the auditor should have detected: “It would lame the very concept of an audit – a check on management for the benefit of shareholders – if the higher the level of managerial fraud, the lower the auditor’s responsibility”. He said the Hampshire Land principle was also relevant here, as it illustrated that the interests of the Company and of Mr Stojovic had to be distinguished, precisely because it was among the Auditors’ functions to ensure to the former a degree of protection against the latter.

Lord Mance, like Lord Scott, pointed out that in an insolvency situation there was no prospect of the fraudster getting the benefit, qua shareholder, of a successful damages claim. He said that, if the issue arose in a solvent company situation, English law would find a way to address it, for example by enabling
the company to impound the delinquent manager/ shareholder’s share of the distribution.

The fact that the Company was insolvent at each audit date was, in Lord Mance’s view, critical: the issue was whether the auditors’ duty to the company extended, like the directors’ beyond the protection of the interests of shareholders in a situation where the auditors ought to have detected that the company was (in fact, as a result of a fraud which the auditors ought to have discovered) insolvent. Lord Mance said it would not be inconsistent with Caparo to hold auditors liable in these circumstances because neither Caparo nor any of the other audit cases addressed auditors’ liability for failure to pick up a fraudulent scheme rendering the company increasingly insolvent. He emphasised Lord Oliver’s statement in Caparo that an auditor’s duty was, first of all, “to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing”. Lord Mance pointed out that the company’s claim in such circumstances was for precisely the same loss as the loss which a company with some shareholders innocent of involvement in top management’s fraud would be entitled to claim from negligent auditors who had failed to detect and report the fraud. He added that it could not be said that the care to be expected of the Auditors varied according to whether all of the Company’s shares were owned and/or controlled by Mr Stojcic: recovery did not depend on the happenstance of whether or not all of the Company’s shareholders were involved in the fraud.

Lord Walker posited the negative test of a company which has no individual concerned in its management and ownership other than those who are, or must (because of their reckless indifference) be taken to be, aware of the fraud or breach of duty.

- As Lord Mance pointed out, whether a company is a “one man” company or not may itself be unclear, particularly where there is a web of nominee or trust shareholdings. The evidence on that issue alone may be sufficiently unclear to prevent this ruling being used again on a strike-out.

The limited application of the House of Lords’ ruling means that it is the auditors of small, privately-held companies who have most to cheer from this decision. Auditors of listed companies, in particular, are unlikely to be affected.

That said, it is the small companies dominated by individuals which may be thought to present the greatest fraud risk to investors and counterparties. Lord Mance began by saying “The world has sufficient experience of Ponzì schemes operated by individuals owning “one man” companies for it to be questionable policy to relieve from all responsibility auditors negligently failing in their duty to check and report on such companies’ activities”, and he concluded with a warning that is particularly pertinent in the current climate where the Madoff scheme and other investor frauds have been exposed:

“The…result espoused by the majority of your Lordships will weaken the value of an audit and diminish auditors’ exposure in relation to precisely those companies most vulnerable to management fraud. The (too topical) lesson for creditors or depositors might be said to be that they should not expose themselves to one-person companies, at least without extensive due diligence.”

Another significant feature of their Lordships’ Opinions was the analysis of the auditors’ duty of care in an insolvency context. Lord Mance posited that the duty of auditors, like that of directors, could extend to protecting the interests of creditors where the auditors ought to have detected that the company was insolvent (or, possibly, potentially so) as a result of a fraud which the auditors ought to have spotted. Lord Phillips’ comments on this were illuminating in that:

Comment

This is a landmark decision, in that it is the first time in this jurisdiction that the ex turpi rule has been applied to defeat a claim in negligence against auditors. The mere fact that it has been shown that the ex turpi rule can operate in this way is itself good news for auditors.

That said, the decision is likely to be of limited application:

- Both Lord Phillips and Lord Walker emphasised that this was an “extreme” case on its facts.

- The reasoning of the majority was limited to the situation where the fraud is that of a “one man” company. Looking at the speeches of the majority as a whole, this probably means a company where there are no “innocent” shareholders (ie no shareholders who are not complicit in the conduct of the fraudster).
• he appeared to think that this would involve an extension of Caparo principles, whereas (as Lord Mance demonstrated) neither Caparo nor any other reported decision on an audit had dealt with this issue, which was therefore open on the authorities; and

• he himself said ‘It is arguable that the scope of the duty undertaken by the auditors of a company should extend to protecting the interest that the creditors have in the preservation of the assets of the company”, without expressly limiting that idea to an insolvency context.

Their Lordships’ comments on this issue are probably obiter, and it will therefore continue to be arguable that, at least in an insolvency (and, possibly, a near-insolvency) context, the auditors’ duty should extend to the protection of creditors. In the current economic environment, this may provide food for thought for office-holders looking to recover something for creditors where the assets of a failed company are insufficient to provide a satisfactory payout. That said, particularly with the heightened attention being given by audit teams to “going concern” issues in the current climate, it is difficult to see a situation, short of fraud, in which auditors would fail to spot the insolvency or near insolvency of an audit client at the report stage; and, in a fraud environment, the principles of attribution discussed here would again be in play and the “one man” company rule could operate as an obstacle to an audit negligence claim.

Finally, this decision brings to an end one of the largest and highest profile actions yet run in this country with the aid of commercial third party funding. The funders in this case, believed to be IM Litigation Funding, can now expect to be ordered to pay the auditors’ costs of the action. It remains to be seen whether this reverse will have a negative impact on third party funders’ appetite for litigation risk in this jurisdiction.

Hardeep Nahal

Pamela Kiesselbach
Damages for loss of chance to profit from trading strategy

The recent decision of Mr Justice Flaux in Parabola Investments Limited and Ors v Browalla Cal Limited and Ors [2009] 2 All E.R (Comm) 589 has cast new light on the measure of damages available in fraud cases, and the size of the award has brought litigation risk to the forefront of the minds of many compliance professionals. Although the decision is subject to appeal which will be heard in March 2010, the discussion on the quantum of damages merits closer examination.

Key points

- In cases of deceit, recovery of lost profits is not limited to specific alternative transactions which would have been entered into but for the fraud.
- Because he was able to establish a proven track record of successful (prior) trading, the claimant recovered damages for the loss of the chance to profit from that trading strategy:
  - damages were awarded on the basis that but for the fraud, the claimant would have continued to trade successfully in the shares of smaller companies;
  - in respect of the period after discovery of the fraud, damages were awarded on the basis that, with a larger fund available to it (ie in the absence of a fraud), the claimant would have made greater profits going forward, increasing the total award from £3.2 million to around £20 million.
- It is inappropriate to award exemplary damages against a defendant, even in a case of fraud, where the basis for that defendant’s liability is vicarious liability.

Facts

The claimants were special purpose vehicles set up by one Mr Rajesh Gill, for the purposes of trading on the stock markets. Following several years of incredibly successful trading, during which time, as noted by the judge, Mr Gill earned the title the “7 to 7man”, because he turned a starting fund of £7,000 into £7 million in two years”, in January 2001, Mr Gill moved his trading account to the first and later to the second defendant, Man Financial, which took over the business of the first defendant. The third defendant, Mr Bomford, was the senior broker who conducted the vast majority of the claimants’ trades at the first defendant and later at the second when his desk was transferred across.

By the time of trial, the court was concerned only with the claims by the second claimant, Tangent, against the second and third defendants in respect of the period after the transfer of Mr Bomford’s team to Man Financial from 30 June 2001 until March 2002.

The claim in deceit was essentially that over a period of nearly eight months until 13 February 2002, Mr Bomford fraudulently misrepresented to Mr Gill and thereby to Tangent on a daily basis that the trading being conducted by Mr Gill was profitable when in reality it was not. It was also alleged that Mr Bomford made a series of fraudulent misrepresentations as to the amount of the funds in the account with Man.

As the judge put it:

“The overall effect was to create the intricate web of deceit, perpetrated over a lengthy period, that the trading being carried out was profitable and was building up a fund worth approaching £10 million by the time the truth came out, whereas in fact the fund was diminishing rapidly throughout the period of the deceit. By the deceit Mr Bomford did create the parallel universe in which Mr Gill thought he was trading profitably whereas the truth was, as Mr Bomford colourfully and cynically but correctly described it in conversations with others, Mr Gill was “haemorrhaging money” and “losing his arse”.”

The defendants admitted the allegations of deceit following cross examination of Mr Bomford, but continued to deny the fraud had caused any loss to the claimant, arguing that the deceit had not induced the claimants to trade.

Deciding as a matter of fact and law that the claimant had been induced by the defendants’ behaviour, the Court was left with two issues to determine: first, the identifiable heads of loss suffered as a consequence of the fraud; and secondly, the measure of damages recoverable as a direct result of the fraud.
Tangent’s claim was made under two heads. First, it claimed for the diminution in the value of its trading fund during the period of the fraud from £4.25 million at the start of the relationship with Man to just over £0.5 million at the end. Secondly, it claimed loss of profits which it argued it could and would have made on trading had it not been for the fraud.

By this second limb, the claimant sought to recover damages for loss of profits which it says it would have made on alternative trading both during the period of the fraud, and for the period between the end of the relationship until trial, during which time, the judge accepted, Tangent continued to suffer from the fraud.

The defendants’ position

The defendants accepted that if inducement were shown, it would be liable in damages to reimburse Tangent the difference between the value of the trading fund at the beginning of the Man period on 30 June 2001 and its value at the termination of the relationship with Man Financial in March 2002 less any withdrawals, plus interest.

The defendants disagreed that they were liable for lost profits and challenged both aspects of the loss of profits claim on the second head. In argument, they sought to divide the loss of profits into two periods. First, the duration of the trading relationship with the defendants, which they termed “Stage 1”, and secondly the period from the end of the trading relationship to judgment, which they termed “Stage 2”. As regards Stage 1, they argued that cases where loss of profits had been held to be recoverable involved loss of profits on a specific alternative transaction which the claimant would have entered but for the fraud. In contrast, in the current case the claimant had proposed a series of hypothetical alternative transactions. They also argued that the financial products which the claimant traded and used as the basis for his claim were so speculative as not to be recoverable.

The defendants raised the same objection on Stage 2, but added that the claim for loss of profits after the end of the relationship amounted to a claim for what they termed “profits on profits”. This, they said, went beyond what the law considered recoverable in damages. In other words, trading that had occurred after the end of the relationship was not an “alternative transaction” as understood by the deceit cases concerning loss of profits, but rather alternative trades which the claimant Tangent said it would have undertaken during the period of the fraud. Stage 2 was therefore for loss of profits on transactions which the claimant would have entered after the fraud which was entirely speculative and did not flow from any damages for the fraud period, they said, appropriate to compensate the claimant for Stage 2.

Judgment

In a methodical and reasoned judgment, Flaux J found in favour of the claimant, holding that there are no hard and fast rules in determining damages recoverable in deceit, beyond the overriding principle that the court should strive to award damages which compensate the claimant fully for loss flowing directly from the fraud.

The judge held that in deceit cases, recovery of lost profits was not limited to cases where the claimant could point to a specific alternative transaction which he would have entered but for the fraud. Further, there was no requirement that the alternative transaction should necessarily be profitable. The judge also dismissed the notion that because the financial products contained an element of uncertainty the court should regard them as not a recoverable loss.

In this context, the judge accepted the evidence that but for the fraud, the claimant would have continued to trade successfully in the shares of smaller companies, in which it had traded extremely successfully both before the relationship with the defendants and after the end of that relationship. This, the judge said, “is what distinguishes this case from cases like Bailey and Ata, in neither of which was there any evidence that the claimant had made money in the alternative trades in which he was contending he would have engaged.”

Accordingly, as regards Stage 1, the claimant was entitled in principle to recover loss of profits on the alternative trading it would have carried out but for the fraud.

As regards Stage 2, the judge accepted that with a larger fund available to it (ie in the absence of a fraud), the claimant would have made greater profits going forward. The judge could see no reason why, if the adverse effects of the fraud continued on to trial, such that the claimant had not yet achieved the profits from its business that it would have made had the fraud not occurred, damages
should not be assessed at the date of the trial and those lost profits should not be recoverable as damages for the entire period until the trial. He added that “the objection raised by [counsel for the defendants]... that loss of profits after the period of the deceit are not recoverable, because they do not relate to any relevant alternative transaction or because the law does not recognise such “profits” because they are too speculative, it seems to me... is unprincipled and wrong.”

The overriding reason for the judge’s analysis was the notion that the claimant was still suffering the adverse effects of the fraud at the date of trial, or as the judge put it, the claimant remained effectively “locked into the transaction” until trial.

The Court therefore held that lost profits in Stages 1 and 2 were recoverable over and above the damages representing the difference in the fund before and after the relationship with the defendants. The judge assessed quantum in the sum of around £20 million, which represents a considerable uplift on the defendants’ assessment.

Comment

The appeal by the defendants will most probably relate to the lost profits claim (Stages 1 and/or 2), having admitted liability and it having been found as fact that their deceitful behaviour induced the claimant. Such an appeal is likely to centre around arguments of remoteness.

For now, the case will have brought litigation risk firmly back onto the radar for commodities, futures and options dealers who are not infrequently on the receiving end of writs for misrepresentation.

The possibility of recovering what the defendants termed “profits on profits” should serve as a warning to those who embark on a course of deceitful conduct that they could end up facing damages significantly in excess of the loss directly or foreseeably caused to an innocent claimant. The judge’s finding is in line with the ratio of Smith New Court Securities Ltd, the leading authority on damages for the tort of deceit, and its application to a litigant who was found to have been “locked into” the fraud for the past seven years should not have come as a surprise to legal practitioners.

It is difficult to criticise the Court’s logic in reaching the conclusion that the defendants were liable for the Stage 1 and Stage 2 losses also. Although it is beguiling to follow the defendants’ characterisation of the lost profits claim as dividing neatly into Stage 1 (during the fraud itself) and Stage 2 (after the fraud), it is suggested that this too easily allows a defendant who has caused the claimant to be in Court in the first place to escape liability on the basis of his own characterisation. In other words, if one considers first the claimant’s usual and proven track record not in terms of stages, but rather as a straight line graph and then plots the claim period alongside (ie the defendants’ Stages 1 and 2), it is easier to appreciate why the Court was prepared to accept that the only way the claimant’s putative performance (as represented by the straight line graph) could be achieved would be by awarding the “profits on profits” claim.

This sort of measure may well be exceptional; indeed the Court relied on the speech of Lord Browne-Wilkinson in Smith New Court as a departure from the usual rules of valuation. That departure appears itself be down to the unusually consistent rate of success of the claimant’s trading both before and since the fraud. Indeed, the Court noted that Rajesh Gill, the beneficial owner of the individual behind the claimants was “regarded by those who have dealt with him as one of the most successful traders in certain types of stocks and shares and their derivative products on world markets. Over the period of more than ten years since he left university, other than in one period, Mr Gill has consistently made profits from his trading, whether in bull or bear markets, sometimes extraordinarily good profits despite the state of the world markets”.

But does such an ecumenical analysis miss the point of this and other cases dealing with deceit? Even in the absence of Mr Gill’s phenomenal trading success, it would seem entirely contrary to the thrust of their Lordships’ speeches in Smith New Court to allow a defendant which has admitted liability for the most egregious kind of deceit to dictate the rules of recovery of the monies of which he caused the defendant to be deprived. In Parabola, the Court was satisfied that but for the fraud, the claimants would have continued up the straight line, making profit as they always had done before their relationship with the defendants. No matter, though, how steep or gentle a claimant’s straight line, it would seem at odds with the principles of tortious damage to say he should not be allowed to ride it, even if that means that the outcome of cases will vary according to the nature of the claimant. Tangent clearly had a single trading strategy based on a discernable formula; the behaviour of the defendants knocked them off that strategy. This judgment suggests
that a claimant who has a strategy can recover provided he
can point to convincing evidence of that strategy in Court.

Exemplary damages

As an endnote, it is notable that the Court refused the claim for
exemplary damages in a further death knell for such an award.
Although the judge agreed with the dissenting Lord Scott in
Kudlur v Chief Constable of Leicestershire [2002] 2 AC 122,
that “the time has come to abolish exemplary damages”, he
felt he could not ignore their existence, but added that he
could not make such an award where, as in the current case,
a defendant such as Man Financial was liable vicariously. The
judge added that “there seems to me something faintly absurd
in the suggestion that, in this case where Tangent will recover
substantial compensatory damages, the additional award of
even £15,000 exemplary damages will express the court’s
outrage and displeasure at the fraud perpetrated on Tangent
and Mr Gil.” We can expect further erosion of the doctrine of
exemplary damages in the near future.

John Corrie

Stop press

The defendants did indeed appeal on the question of the extent of damages. The Court of Appeal in a recent
judgment has upheld the judgment of the High Court.
The Bribery Act: Commentary on the new offences

The Bribery Act received Royal Assent on 8th April 2010. The offences will come into force at a date to be appointed by the Secretary of the State. We will advise of such dates as soon as information becomes available. We consider it unlikely that the new corporate offence will come into force before October, although the new Government may have different priorities.

Overview of the Act

The Bribery Act repeals the existing legislation and creates four new offences:

- an offence of active bribery (ie giving, promising or offering a bribe), which applies in the public or private sector;
- an offence of passive bribery (ie requesting, agreeing to receive or accepting a bribe), which applies in the public or private sector;
- a specific offence of bribing a foreign public official; and
- a new ‘corporate’ offence which applies where a corporate or partnership fails to prevent those performing services on their behalf from paying bribes.

The only defence to this offence is to show that an organisation had in place “adequate procedures” to prevent such bribery.

In the following commentary on the Act we explain the new offences and how they may work in practice.

First offence:

Section 1: Offence of bribing another person

There are four parts to this offence:

Part 1 The briber, P, offers, promises or gives a financial or other advantage to another person;

Part 2 Either:

- intending the advantage to induce a person to perform improperly a relevant function or activity (Case 1a); or
- intending the advantage to reward a person for their improper performance of a function or activity (Case 1b); or
- knowing or believing that the acceptance of the advantage would itself constitute the improper performance of a function or activity (Case 2).

Part 3 The offence applies to functions of a public nature, or activities connected with a business, trade or profession or activities performed in the course of a person’s employment or on behalf of a body of persons (including unincorporated bodies).

Part 4 “Improper performance” will be assessed by first considering whether the person performing the function or activity was:

- expected to perform it in good faith, or
- expected to perform it impartially; or
- in a position of trust.

It is then necessary to consider whether the performance is in breach of the relevant expectation or there is a failure to perform the function or activity and that failure is itself a breach of a relevant expectation.

Key legal issues

- It is irrelevant whether the advantage is offered, promised or given directly or through a third party, ie, the offence expressly applies where an agent is used to pay a bribe.

- The offence uses both a subjective and an objective test for determining what is meant by improper performance. For example, to commit the first variant of the offence, a person has to intend the advantage to induce a person to perform a function or activity improperly (a ‘subjective’ test - i.e., one relating to the defendant’s state of mind). However, in order to determine what is expected of a person carrying out those functions or activities a ‘reasonable person test’ is adopted (an ‘objective’ test).

- In the Act, the objective “expectation test” was limited to the expectations of a reasonable person in the UK. There was a question mark over the extent to which different cultural practices should be taken into account. There was a concern that adopting a wider
test would lower the threshold. The Law Commission had previously stated that individuals should not be able to escape conviction simply because their otherwise criminal conduct amounted to a tolerated practice abroad. However, they did accept that some cultural norms, including the extent to which one country entertains more lavishly than another, should be taken into account as part of whether the expectation of good faith, impartiality or trust, had been breached.

The Joint Committee who considered the draft Bill last Summer (2009) asked the Government to clarify its approach in this area. In the Act, Parliament provided that where the performance of the function/activity is not subject to UK law, local custom or practice is to be disregarded unless it is permitted or required by local written law (defined as a written constitution, legislation or case law which is evidenced in writing).

In practice this means that if an inducement or reward is intended to reward activity abroad which would be considered to breach a relevant expectation in the UK, then the potential offender will need to ensure that local written law expressly permits such behaviour.

- Both this offence and the offence of receiving or soliciting a bribe continue to apply to both the public and private sectors. Given the broad scope of the offences, companies should consider their procedures in relation to the receipt of payments, gifts or hospitality as well as in relation to their provision.

**Key practical issues/examples**

- For example, Jim the salesman offers his contact, Neil, tickets to the World Cup. Neil is in the procurement department of the firm Jim is trying to obtain a contract from. If the tickets are offered to Neil in return for Neil providing information as to the other bids submitted as part of a tender exercise, Jim would commit the Section 1 offence. He has offered an advantage, intending Neil to perform his functions improperly as he expects a quid pro quo for his offer. Neil is involved in an activity connected with a business and if Neil accepted the offer he would most likely fail to perform his activity or function impartially, he may well also not perform it in good faith either.

- One issue which the Joint Committee had concern with is that conduct which ought to be viewed as a civil wrong may, in future, be criminalised. The example was given to the Joint Committee of a banker being asked by a rival bank to induce his or her trading team to join that rival in return for increased remuneration, ie. that this might breach an expectation of good faith. It was suggested that guidance could be included in the Act making it clear that mere civil wrongs should not necessarily be viewed as bribery.

However, the Guidance that is provided for in the Act is only in relation to the new corporate offence and not in respect of any of the other three offences. The Government in its Response expressly stated that, as it is often the case that civil and criminal law duties overlap, it should be a matter of prosecutorial discretion, exercised in the public interest, which determines the issue.

**Second offence:**

**Section 2: Offences relating to being bribed**

There are four different situations where a person, R, will be guilty of committing an offence in respect of receiving a bribe. These are where:

| Case 3 | TR requests, agrees to receive or accepts a financial or other advantage intending that a relevant function or activity should be improperly performed by R or another; |
| Case 4 | the improper performance of a function or activity (Case 2). |
| Case 5 | R requests, agrees to receive or accepts a financial or other advantage as a reward for the improper performance of a relevant function or activity by R or another; |
| Case 6 | R or another (at R’s request or with his assent or acquiescence), in anticipation of or in consequence of R requesting, agreeing to receive or accepting a financial or other advantage, improperly performs a relevant function or activity. |

**Key legal issues**

- These offences apply to the improper performance of functions and activities as set out above. The benefit need not be for R and the request, agreement or acceptance can be through a third party.
• In Cases 4-6, it is irrelevant whether R knows or believes that the performance of the function or activity is improper. The Joint Committee accepted that this means a person can be liable to prosecution without proof of intention, but justified it as “an important part of changing the culture in which taking a bribe is viewed as acceptable”. Therefore, whilst to be guilty the briber, P, must intend (or have the requisite intention) that the performance of R’s duty be improper in consequence of the advantage offered or conferred, the bribee, R, can be guilty even if he does not know that his performance is improper. The rationale is perhaps explained by the Joint Committee’s further comments that this should encourage those expected to act in good faith, impartially, or under a position of trust to “think twice” before accepting an advantage for personal gain.

Key practical issues/examples

• Given that some of these offences may be prosecuted without proof of intent, companies will need to ensure that bribery does not impact upon their own procurement procedures. For example, those with influence over the gift of work to suppliers will now be at greater risk of prosecution where they accept generous hospitality from a supplier. In such cases the prosecution will not have to prove that they accepted it intending to perform a function or activity improperly, rather it will be sufficient if the prosecution can prove that a reasonable person considered that in accepting the offer they would have performed their functions or activities improperly, as adjudged by the ‘reasonable person test’.

Extra territorial scope

• Both of these offences apply to acts committed overseas (where the act or omission would have been an offence if done or made in the UK), provided the offender has a close connection with the UK. A close connection includes a British citizen, a British overseas territories citizen, an individual ordinarily resident in the UK or a body incorporated in any part of the UK etc.

Third offence:

Section 6: Bribery of Foreign Public Officials

Notwithstanding the extra-territorial scope of the new offence of bribery (see above), the Act contains a specific offence of bribing a foreign public official. There are four parts to this offence:

Part 1 The briber, P, must intend to influence the foreign public official, F, in his capacity as a foreign public official;

Part 2 P must intend to obtain or retain business or an advantage in the conduct of business;

Part 3 P must directly or through a third party, offer, promise or give an advantage to F or to another person at F’s request or with F’s assent or acquiescence.

Part 4 An offence is not committed if F is permitted or required under applicable written local law to be influenced in his capacity as a foreign public official by the offer, promise or gift.

Key legal issues

• It is not necessary for P to know or intend that F acts “improperly” - it is sufficient that P intends to influence the official. Similarly, it is not necessary for F to act improperly. The offence closely tracks the requirements of the OECD Convention and is therefore also similar to the FCPA bribery offence (but without the specific defences for bona fide expenses and for facilitation payments available in the US).

• The Act provides a ‘local law’ provision - that an offence would not be committed where the advantage was permitted under applicable written local law. Whilst we recognise that the draftsman wanted to ensure that questionable local practices could not be taken into account, we question how useful in practice the exception will be. Such an exception may not allow local guidance (i.e guidance, which does not have a statutory footing, relating to what gifts and hospitality officials can accept) to be taken into account.

• Belief that local law permits a payment is no defence. For a ‘local law’ defence to apply, local written law must permit or require the official to be influenced by the payment.
Key practical issues/examples

The fact that the new offence does not require the person providing the advantage to know or intend that F would act/acts “improperly” means that advantages which could be seen as legitimate under the FCPA (i.e. reasonable hospitality etc) potentially become problematic under the Bribery Act. Lord Tunncliffe (Government spokesman for the MoJ in the House of Lords) in a letter dated 14 January 2010 appeared to recognise that hospitality for foreign public officials could be problematic under this new offence. “This offence is formulated differently. It requires that the person offering the advantage must intend to influence the foreign public official in the performance of their functions and that the applicable written law neither permits nor requires the foreign public official to be influenced by the offer, promise or gift. (The bribe must also be intended to obtain or retain business or a business advantage). If there is no applicable written law which allows for hospitality in these circumstances, the offence may be committed.”

Take the situation where Jim decides that he wants to offer Mehmet (an official in the Energy Ministry) the opportunity to visit a site developed by his company in Scotland. The reason for the visit is that the site being looked at in Mehmet’s country for a hydro electric station presents a number of geological and logistical difficulties. Mehmet questions whether Jim’s company has the ability to deliver. Jim wants to show Mehmet a number of sites so that he can prove that his company can deliver and that it has dealt with these challenges in the past. He offers a visit to the sites to Mehmet. The visit will require a stay in Scotland of 5 days. Jim’s company agrees to pay for economy flights, reasonable hotel expenses and all 5 days will be spent visiting various sites. There are no per diems to be paid to Mehmet.

In offering such a trip, Jim is wanting to influence Mehmet i.e to show him that the company can deliver. He wants to obtain business. Is he though offering an advantage to the official? He is offering a foreign trip. Is that really an advantage? In the circumstances outlined above does Mehmet gain personally? All he obtains is information which demonstrates that Jim’s company can do what they say they can do. The difficulty though is where does a proportionate and justified trip become legitimate hospitality. Change some of the variables above and the situation becomes very different. For example, what if Mehmet is provided with a per diem of £1000 a day? Clearly this starts to look like the trip was just a mechanism for giving money to Mehmet. What if you give him £500, what about £100, what about £50? What if the trip was for 10 days staying in luxury hotels and there were only two site visits in that time? Again that does start to look like the trip was a mechanism for giving an advantage to Mehmet.

Unless you can show that there was no advantage to the official then as Lord Tunncliffe stated you will have to “rely on prosecutors to differentiate between legitimate and illegitimate corporate hospitality and to decide whether or not it would be in the public interest to bring a prosecution.”

Fourth offence:

Section 7: Corporate offence - Failure of commercial organisations to prevent bribery

A corporate or a partnership will be liable where:

<table>
<thead>
<tr>
<th>Part</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part 1</td>
<td>A, is performing services for or on behalf of the commercial organisation, C;</td>
</tr>
<tr>
<td>Part 2</td>
<td>C can either be a corporate body or a partnership which is either incorporated or formed in the UK or which carries on a business or part of a business in the UK;</td>
</tr>
<tr>
<td>Part 3</td>
<td>A bribes another intending to obtain or retain business or an advantage in the conduct of business for C; and</td>
</tr>
<tr>
<td>Part 4</td>
<td>C is unable to make out the defence of having in place adequate procedures designed to prevent persons associated with it from engaging in bribery.</td>
</tr>
</tbody>
</table>

Key legal issues

- The “corporate offence” is a strict liability offence i.e. failing to prevent a bribe being paid on the company’s behalf, subject to an adequate procedures defence. At an early stage of the Act there had been a proposal that the offence be one of negligently failing to prevent bribery. Those who have been following the development of the Bribery Act will note that the Act adopted the Joint Committee’s proposal that the negligence test be dropped.
- There is, however, as compared to the draft Bill, a slight narrowing of the scope of the offence in that A must
now pay the bribe intending to retain or obtain business for C – previously, C could be liable if A merely paid a bribe in connection with C’s business.

• It is also worth noting that, whilst A must have been shown to have committed the conduct prohibited in Sections 1 or 6 A does not need to be prosecuted before C could be found to be liable. The parent may incur liability for the acts of foreign nationals working overseas.

• C will be liable where someone, A, is performing services on their behalf. The Act provides that it does not matter in what capacity A acts on C’s behalf. The specific examples given in the Act include C’s employees, agents or subsidiaries but this is not an exclusive test. Whilst there is a rebuttable presumption that C’s employees act on behalf of C, as regards other potential situations this will be determined by reference to all relevant circumstances, not merely the relationship between A and C.

Key practical issues/examples

Subsidiaries

• One key issue for companies will be the extent to which subsidiaries (or joint ventures or sister companies) will be found to be performing services on the company’s behalf, and therefore may fall within the definition of “A”. The new offence does not address this point, and it is not clear at this stage to what extent the guidance will cover this issue. This will be of key concern for international business; to what extent are they required to control the acts of subsidiaries or joint venture entities (where companies may well have less of an ability to control the acts of that entity). We understand that not all acts of subsidiaries will incur vicarious liability for their parent entities. It is clear from the Act that an assessment will need to be made on a case by case basis.

Extra territorial application

• The other key issue is the extra territorial impact of the new corporate offence. C includes all companies/ partnerships incorporated in the UK or who carry on business or part of a business in the UK. Given the way the section is worded the corporate offence will apply even in relation to their non-UK business, irrespective of their place of incorporation. In addition A’s actions constituting the act of bribery need not take place in the UK and need have no connection with the UK.

• It will therefore be possible to prosecute a foreign company which carries on business in the UK (for example, one which has a branch office here etc) whose procedures are inadequate, even where A’s actions take place wholly outside the UK and the benefit or advantage to C is intended to accrue outside the UK. Adequate procedures compliant with UK law may therefore be required by any organisation with a presence in the UK in respect of its worldwide operations.

• Most organisations already have some form of global compliance policy, but international organisations will need to look at their global operations and determine whether this offence could be relevant to their group operations (or part of their group operations) and if so whether their procedures are adequate under English law.
The House of Lords sets aside order for examination of foreign officer of judgment debtor

in a recent opinion (Masri v Consolidated Contractors International Co. SAL and others [2009] UKHL 43) handed down in the final days of the House of Lords, their Lordships clarified a point which may be of some significance for successful claimants seeking to enforce a Court order against corporate defendants.

Enforcement is a key (but often overlooked) stage of litigation. While a claimant may succeed in obtaining a judgment in its favour, this is of limited value if the Order cannot be enforced. To assist judgment creditors (ie those who have a judgment in their favour) the Courts have developed a number of tools, including the ability to appoint receivers, freeze assets, levy execution against goods, and obtain orders for payments of debts owed by third parties (such as bank accounts).

However, commonly a judgment creditor will know little about a judgment debtor’s financial position and therefore cannot identify assets against which to bring enforcement proceedings. When this is the case, CPR Rule 71 provides a useful means of obtaining information. A judgment creditor can apply to the Court (without notice) for an order requiring a judgment debtor to provide information (including documents) on his assets to the Court while under oath, and to be questioned on those assets by a court officer or representative of the party. The examination is “not only intended to be an examination, but a cross-examination and that of the severest kind” (Republic of Costa Rica v Stronsberg (1980) 16 ChD 8). A judgment debtor who refuses to attend, or refuses to answer questions risks serious consequences. The standard form order states that “you must obey this order. If you do not, you may be sent to prison for contempt of court.” (See CPR 71.2(7)). CPR 71 is therefore a potentially powerful weapon for a judgment creditor.

CPR 71 is clear that an order can be made against any judgment debtor, including a judgment debtor located outside England and Wales’ and including in respect of that judgment debtor’s assets anywhere in the world. It is also expressly stated that in cases where the judgment debtor is a company or an officer, an order can be obtained requiring “an officer of that body to attend court to provide information...” (CPR 71.2(b)).

The issue before the House of Lords in Masri was whether this power existed in relation to the overseas directors of a judgment debtor. The Court of Appeal had held that it did. However, the House of Lords concluded (unanimously) that CPR 71 was not conceived with corporate officers abroad in mind and, notwithstanding that there was no express exclusion in respect of them, there were no good grounds for regarding the true construction of CPR 71 as including overseas officers.

Lord Mance (with whom the other four Lords of Appeal in Ordinary agreed) considered authorities in relation to the similar power to examine overseas officers of insolvent companies but held that there were different public policy considerations in relation to the public interest in investigating those accountable for a company’s state of affairs, and private civil litigation between two parties.

The Court further held that even if CPR 71 did create a power to make an order in relation to overseas directors and officers, then CPR 6 did not provide any basis for service of any order out of the jurisdiction.

Comment

This is an unwelcome decision for claimants faced with a corporate defendant. In his judgment, Lord Mance noted that “small though the world may have become, relatively few officers of companies are likely to contemplate, late alone be able to undertake, emigration or flight to a different country in order to avoid giving information about their company’s affairs” (at paragraph 25 of the judgment). While this may be true in relation to officers of large multinationals and good corporate citizens, it is perhaps more questionable whether the same can be said about all counterparties, particularly those which may be involved in fraud proceedings.

Commonly in fraud cases, the wrongdoer is a corporate entity, often incorporated overseas, or with overseas directors with no obvious assets. Following Masri it may be significantly more difficult for claimants to obtain information on the assets of those companies. It will therefore be of crucial importance for claimants to consider issues relating to enforcement and assets at the outset, and to consider, where possible, joining individual directors or beneficial owners to a claim to permit enforcement proceedings to be brought against them directly (and for them to be examined on their assets), where appropriate.

Gareth Keillor

Tom Kemp
Recent developments on *Norwich Pharmacal* jurisdiction

In *R (on the application of Mohamed) v Secretary of State for Foreign and Commonwealth Affairs* [2008] EWHC 2048 (Admin), the English High Court reaffirmed the flexible nature of its Norwich Pharmacal jurisdiction to order disclosure of information and documents from third parties innocently caught up in wrongdoing, essential to assist parties to pursue their cases. Norwich Pharmacal relief is an important weapon in the fraud litigator’s armoury, with a whole host of uses, described below. In recent years, however, there has been a concern that its utility was becoming restricted by the Court imposing ever more barriers, causing fraud specialists to opine that the relief was falling out of favour. *Mohamed* is excellent news for fraud practitioners, as it confirms the flexibility of Norwich Pharmacal relief.

The key points of *Mohamed* are that:

- **Norwich Pharmacal relief continues to be a flexible remedy for parties at all stages of litigation, including pre-action and post-judgment;**

- **The relief can assist anyone who lacks information and/ or documents essential to his case, in all contexts, whether civil or criminal, when the necessary elements are established;**

- **Very often Norwich Pharmacal relief empowers persons who have been wronged, but do not know exactly by whom, to pursue their claims, by revealing the wrongdoer’s identity.** However, the ambit of potential relief is open and is tailored to the needs and circumstances of the case;

- **The relief can be particularly helpful in fraud and other cases involving dishonesty and/ or potentially criminal conduct;**

- **Courts are naturally careful in deciding whether to grant Norwich Pharmacal relief and will not allow a fishing expedition, but significantly, Mohamed makes it clear that Courts must not set the test too high or confine the jurisdiction within artificial barriers;**

- **Ultimately the granting of the relief turns on what is in the interests of justice;**

- **While important, the jurisdictional barriers to the relief, such as the respondent’s presence in England and the Court’s powers of implementation, are often surmountable through (eg) the availability of Norwich Pharmacal relief (or its equivalent) in other jurisdictions, ancillary to proceedings in England or otherwise; letters of request; and effective undertakings by applicants.**

**Elements necessary to obtain Norwich Pharmacal relief**

To appreciate the impact of *Mohamed*, it is helpful first to review the basics of Norwich Pharmacal jurisdiction. The relief derives its name from the House of Lords’ decision in *Norwich Pharmacal Co v Commissioners of Customs and Excise* [1973] 2 All ER 943. Applicants must show:

- **a reasonable basis to allege that a wrong has actually or arguably been committed by an ultimate wrongdoer;**

- **the disclosure of documents or information from the respondent is needed to enable action against the wrongdoer;**

- **the respondent is not a “mere witness”, but is sufficiently mixed up in the wrongdoing so as to have facilitated it, even innocently, and therefore be in a position to provide the information sought; and**

- **the order is necessary in the interests of justice on the facts of the case.**

**Norwich Pharmacal compared to pre-action and non-party disclosure, witness summonses and letters of request**

The scope of the relief differs from that of pre-action disclosure under Rule 31.16 of the Civil Procedure Rules (“CPR”), which allows the Court to order disclosure of documents against respondents who are likely to become parties to the expected proceedings. In contrast, Norwich Pharmacal relief targets third parties who are unlikely to become parties to any proceedings (because they themselves are not wrongdoers), but who hold a key to unlocking the possibility of proceedings, whether by way of documents or information.

Once an action is underway, the Court has power under CPR 31.17 to order, against a person who is not a party to the proceedings, disclosure of documents likely to adversely affect the respondent, and/or support the applicant. However, Norwich Pharmacal relief may provide access to more than just documents and has a wider test: the order must be in the interests of justice. CPR 31.18 confirms that neither CPR 31.16 nor CPR 31.17 limit the Court’s Norwich Pharmacal powers: the remedies co-exist, with the most appropriate strategy for calling upon them depending on the facts of a specific case.
As an alternative to Norwich Pharmacal relief and disclosure under CPR 31.17, parties to proceedings might seek evidence from a witness and/or production of documents through the witness summons procedure in CPR 34.2, which requires the Court’s permission if the witness is to attend court or produce documents. The summons must be sufficiently certain to enable the witness to comply and can only require the production of evidence and documents which could be required at a hearing. In contrast, applicants for Norwich Pharmacal relief might never get to trial without the information or documents sought, which may or may not be relevant to the substantive issues to be tried. Witness summonses might assist where evidence and/or information is needed from a “mere witness” or a party, against whom Norwich Pharmacal relief is not available.

Mohamed: background facts

Arrested in Pakistan in April 2002, Mr Mohamed was held incommunicado in various locations until his transfer to Afghanistan in May 2004 and thence to Guantanamo Bay. During that time, he was interrogated by or on behalf of US government officials. After May 2004, Mr Mohamed confessed to US officials that he had been involved in Al-Qaeda and in terrorist activities. On the basis of those confessions, he was charged with terrorist offences under the United States Military Commissions Act. Before the charges could be considered by a Military Commission, the Convening Authority established under that Act had to decide whether the charges should be referred for trial. Mr Mohamed, seeking to avoid this referral, alleged that his confession had been obtained as a result of torture between April 2002 and May 2004.

The UK Government was not involved in the US interrogations. However, the UK Foreign Secretary accepted that Mr Mohamed’s allegations were arguable and that documents existed which might be considered exculpatory, or otherwise relevant to the US Military Commission trial. Mr Mohamed requested these documents, but the Foreign Secretary refused, on the basis that he had no duty to disclose them, and that disclosure would cause significant damage to the UK’s national security.

Mr Mohamed applied to the English High Court, inter alia, for Norwich Pharmacal relief to be granted, requiring the Foreign Secretary to provide the documents and information.

The decision of the English High Court

The Court granted Norwich Pharmacal relief, noting that the jurisdiction offers an exceptional though flexible remedy, which can adapt to novel circumstances, enabling applicants to obtain information essential to a fair trial when the elements are met. The Court reiterated that only an arguable case needs to be shown and that innocent participation by respondents is sufficient. In Mr Mohamed’s case, the UK Government was not a “mere witness”, because it had facilitated Mr Mohamed’s interrogation by having at the relevant time knowledge of the reports of his interviews, which contained information about his detention and treatment, although it had itself not been involved in the matter.

Importantly, the Court criticised the High Court’s decisions in Mitsui & Co Limited v Nexen Petroleum UK Limited [2005] EWHC 625 (Ch) (in which Herbert Smith LLP acted for the unsuccessful applicant) and Nikitin v Richards Butler LLP [2007] All ER (D) 129 (Feb). It regarded Mitsui as wrongly characterising Norwich Pharmacal relief as a remedy of last resort, available only if the innocent third parties were the only practicable source of information. In the Court’s view, Nikitin had unduly increased the test of what was necessary to enable action by referring to information or documents “vital” to a decision to sue or ability to plead, which could not be obtained from other sources. The Court in Mohamed preferred the approach in Campaign against Arms Trade v BAE Systems plc [2007] All ER (D) 324 (Feb), which emphasised that the Court should, and was entitled to, have regard to all the prevailing circumstances in the matter in hand. Accordingly, Mohamed regarded Mitsui and Nikitin as having built “artificial barriers” around the relief, by unduly narrowing the ambit of the Court’s discretion and cluttering the content of “necessity”.

Comment

By properly applying the authorities, Mohamed helpfully clarifies that the test for Norwich Pharmacal relief should not be constrained, for example in the ways which contributed to the applications in Mitsui and Nikitin being unsuccessful. Mohamed reinforces that the imperative of the jurisdiction is to achieve justice, which demands a flexible approach. The scope of the information which might be ordered is case-specific and not confined to the identity of wrongdoers or the “missing piece of
the jigsaw”. Although only a first instance judgment, 
Mohamed is perhaps of greater persuasive weight 
than Mitsui or Nikitin, as it was decided by two judges, 
including Thomas LJ of the Court of Appeal. Mohamed 
is also interesting because it involved the High Court 
applying Norwich Pharmacal case law, which has 
developed in a commercial context, to a public law 
human rights claim.

Post-script

It will be interesting to see whether the ECHR’s recent 
decision in Financial Times Limited v UK (App. no. 
821/03) has any bearing on the English court’s approach 
to Norwich Pharmacal relief outside the context of 
orders requiring journalists to reveal their sources. The 
Financial Times had relied on leaked documents to 
publish an article about the planned takeover of South 
African Breweries by Interbrew. The Court of Appeal held 
that the public interest in protecting the source of the 
leak was not sufficient to withstand the prevailing public 
interest in allowing Interbrew to seek justice against the 
source of the leaked information. The ECHR disagreed, 
finding a breach of the Financial Times’s right to freedom 
of expression under Article 10 of the ECHR. It held that 
Interbrew’s interests were insufficient to outweigh that 
right, notwithstanding the serious consequences of the 
leak on the share market, the interests of justice and 
concern in relation to the prevention of crime. Applied 
narrowly to journalistic cases, this case shows Article 
10 intervening with the Norwich Pharmacal test of 
necessity. Mohamed’s restoration of necessity to its 
lower threshold may encourage respondents to try and 
make more use of human rights arguments, including, 
for example the right to privacy, protected under ECHR 
Article 8.

Stuart Paterson

Anna FitzHerbert

footnotes

1. The relief granted in Mohamed was subject to the Foreign Secretary’s provision of a Public Interest Immunity Certificate 
identifying a real risk of serious harm to the UK’s national security if disclosure occurred. An overview of the subsequent 
judgments is given in [2009] EWHC 152 (Admin).
Contributory negligence and contribution in cases of deceit

The decision of Mr Justice Christopher Clarke in Nationwide Building Society v Dunlop Haywards (DHL) Limited (t/a Dunlop Heywood Lorenz), Cobbets (A Firm) [2009] EWHC 254 (Comm) is a good example of the effect of fraud on the defence of contributory negligence.

Introduction

This case is interesting because it shows how in a multi-party case where there is a contribution claim, the fraud of one defendant can impact on the levels of contribution to be made by that party. It also emphasises the rule that a fraudulent party will be unable to avail itself of the defence of contributory negligence, which may be available to the other (non-fraudulent) defendants.

Background

In 2005, the claimant building society (“Nationwide”) made two loans secured against commercial property. The property had been valued by an employee of the first defendant, Dunlop, who fraudulently overstated its value. The second defendant, Cobbets, was the firm of solicitors which had acted for Nationwide on the transaction. Cobbets’ retainer with Nationwide contained a clause limiting the firm’s liability to £5 million.

The claimant commenced proceedings seeking damages from Dunlop and Cobbets in the sum of approximately £21 million. It subsequently obtained summary judgment against Dunlop on its deceit claim. The negligence claim it had brought against Cobbets for failing to detect Dunlop’s fraud, was settled for approximately £5.6 million.

The issues that remained outstanding were: (i) the quantum of Nationwide’s claim against Dunlop; and (ii) Cobbets’ contribution claim against Dunlop under the Civil Liability (Contribution) Act 1978 (the “1978 Act”).

Decision

Mr Justice Christopher Clarke held that the quantum of Nationwide’s claim against Dunlop was £15.5 million, constituting the total recoverable losses, less the settlement monies received from Cobbets.

Having paid the settlement monies, Cobbets sought contribution from Dunlop. For the 1978 Act to apply, the defendants had to be liable in respect of the “same damage”, which led to an examination by the court of the nature and extent of the defendants’ common liability. As against Dunlop, Nationwide had been held entitled to recover all its losses directly flowing from its reliance on Dunlop’s fraudulent statement, including consequential losses and loss of profits. In contrast, the judge found that several heads of damages awarded against Dunlop could not reasonably have been foreseen by Cobbets, whose liability was limited by remoteness of damage. Taking these factors into account, the court assessed the amount of the common liability between Dunlop and Cobbets as £13.2 million.

The court then considered how to deal with the question of contributory negligence. The House of Lords in Fitzgerald v Lane [1983] AC 328 established the ordinary rule that where that defence is available to defendants, the deduction for contributory negligence is made from the total recoverable losses first, and thereafter that reduced figure is apportioned between the defendants. The situation is different where one defendant is negligent and the other is fraudulent, as the defence of contributory negligence is not available to a fraudulent party.

Mr Justice Clarke stated that it was “neither just nor equitable that the amount of contribution which Cobbets are to be ordered to make should be assessed by treating the damage for which both defendants are responsible as the totality of the claimant’s loss, ignoring contributory negligence, when the only reason for ignoring it is that the claim against Dunlop is in deceit. To do so would be to visit on Cobbets the approach taken by the Court, partly for reasons of deterrence, against fraudsters, when Cobbets are innocent of any fraud.” The judge’s solution was to apply the contributory negligence deduction to the £13.2 million “same damage” figure in order to determine Cobbets’ share. Deciding that it was appropriate to deduct 50% for contributory negligence, the judge held that £6.6 million was left to be apportioned between the two defendants.

The judge then considered how to deal with the contractual limitation defence. He rejected Cobbets’ argument that the figure of £6.6 million should be further reduced to take account of the contractual limitation...
which Cobbets had agreed but Dunlop had not. This, he said, would be inconsistent with section 2(3) of the 1978 Act which provides (inter alia) that where a defendant’s liability to the claimant would have been subject to a contractual limit, that defendant cannot be made to pay more as a result of a contribution claim than the amount it would have had to pay to the claimant as limited under the contract. Accordingly, the contractual limitation clause was only to act as a cap on Cobbets’ share of the liability once the correct apportionment had been determined. The judge did however suggest that the position would be different if both defendants had agreed a contractual limitation clause but one party was unable to rely on it as a result of its fraud.

Mr Justice Clarke then went on to consider the proportion in which the two defendants should contribute. He considered that it would be just and equitable to apportion liability 80:20 to Dunlop, since “the moral blameworthiness of Dunlop and the causative potency of the fraud of its agent” were very much greater than that of Cobbets, whose “failing was to pick up on the fraudulent scheme rather than to play any part in it”. This meant that Cobbets’ proper share was 20% of £6.6 million: £1.3 million. Cobbets was therefore entitled to a contribution of £4.3 million from Dunlop (i.e. the £5.6 million Cobbets had paid Nationwide in settlement, less £1.3 million as its proper share of the liability).

Comment

This case is useful in showing how contribution is likely to be assessed where one defendant has been fraudulent and the other has not. It shows that the defence of contributory negligence is available to reduce the negligent defendant’s liability even where the other defendant is unable to avail itself of that same defence. Whilst Cobbets’ share of the liability was reduced to £1.3 million, Dunlop, on the other hand, was liable for £15.5 million plus the balance owing to Cobbets, a total of £19.8 million.

The case therefore also emphasises the extent of damages a fraudster can expect to face if the case ever reaches trial. It also reiterates that a fraudster cannot rely on a defence of contributory negligence. In both respects, it sits well with the case of Parabola Investments Limited and Ors. v Brownalia Cal Limited and Ors. [2009] EWHC 1492 (Comm.), discussed earlier in this briefing.

Natasha Batson
Court of Appeal brands privilege against self-incrimination a “fraudster’s refuge”

Overview

Parties who were subject to a freezing order sought to rely on the privilege against self-incrimination to avoid disclosing their assets, arguing that disclosure would lead to a prosecution in Kazakhstan. The High Court and Court of Appeal dismissed their arguments, stating that the alleged threat should be weighed up in the balance against the prejudice which the claimants would suffer if disclosure was not ordered. The Court of Appeal also suggested that the attempt to rely on the privilege in this way was an attempt to “defeat the ends of justice”.

Impacts - a practitioner’s view

Any person bringing a claim which makes serious allegations, or seeking an injunction which requires disclosure, gives thought to the possibility that the defendant will seek to avoid answering questions put to him, in reliance on the privilege against self-incrimination. In fact, in our experience, the privilege is raised much less frequently than it could be, often because those who commit frauds and other serious crimes seem incapable of recognising that they have done anything wrong. The privilege against self-incrimination will also not excuse the defendant from providing a defence in civil proceedings. Nevertheless, as this case shows, from time to time the plea is raised, and in today’s environment with increased concern as to bribery and corruption, the chances of the plea being raised in civil proceedings is all the greater. The decision in JSC BTA Bank gives the claimant one less thing to worry about when seeking an injunction.

Introduction

In a plain-speaking and direct judgment, the Court of Appeal in JSC BTA Bank v Abyzov & others [2009] EWCA Civ 1125 refused an appeal against an order of the High Court that certain defendants subject to a freezing order must disclose their assets to the court. The defendants sought to rely on the privilege against self-incrimination, asserting that the information provided would be used against them in Kazakhstan. Their argument found no favour with the Court of Appeal which made interesting observations on the privilege.

Facts

The claimant, a major Kazakh bank, obtained a freezing injunction against several former senior officers and an English company and individuals associated with them. The injunction contained an order for disclosure about the extent and location of certain assets. The former bank employees, now residing in London, appealed the order, submitting that the High Court was wrong to require that they provide disclosure pending their application to discharge the injunction.

Before the High Court, the defendants argued that the disclosure questions were intended to improve the substantive case against them, rather than to locate and preserve assets. Teare J rejected that submission, and held that the questions were designed to trace funds over which a proprietary claim had been made. He had concluded “on balance this is a case where there is a greater risk of prejudice to the claimants if the order is refused than to the defendants if the order is made” and made the order for disclosure.

The appeal

The central plank of the defendants’ appeal was that the order for disclosure ought not to have been made because the defendants did not have adequate opportunity to consider their position, particularly whether to claim privilege against self-incrimination in view of criminal proceedings against them in Kazakhstan. Disclosure, they argued, should not have been ordered because the information provided could be used by the Kazakh prosecuting authorities with whom, they alleged, the claimant bank had a close relationship. The judge was wrong, they submitted, merely to balance that risk against the prejudice to the claimant if the information was not provided until later. In contrast, the defendants would be irreversibly prejudiced by disclosure in view of the alleged threat from the Kazakh authorities.

The defendants also submitted that the judge had wrongly taken into account the absence of any substantive defence to the underlying claim. They added that they had not had sufficient time between receiving notification of the injunction and the hearing to take advice on the question of whether they should seek to avoid disclosure on the ground that it would tend to
incriminate them in Kazakhstan. They had also not been served with pleadings by the time of that hearing and English was not their first language.

In view of the lack of time to consider their position, the defendants argued that it was foreseeable that a claim for privilege against self-incrimination would in future be made. They relied on Tate Access Floors Inc v Boswell [1991] Ch 512, which provided that: “Where an ex parte order is sought which might in practice preclude the defendant from raising the claim to privilege before the order is executed, the judge should not have made the order” (at 530).

In response, the claimant bank relied upon the judgment of the Court of Appeal in Motorola v Uzan & Ors [2002] EWCA Civ 989 which recorded that without disclosure, a freezing order would be a “relatively toothless procedure in the fight against rampant transnational fraud” because “the disclosure order, where there is a freezing order, is intimately involved in the effectiveness of the freezing order”. The bank also highlighted that the decision against which the defendants had appealed was based on an exercise of discretion, which could be overturned only in very limited circumstances.

**Judgment of the Court of Appeal**

The Court of Appeal unanimously dismissed the appeal.

Lord Justice Pill noted first that in the context of the privilege against self-incrimination there was a difference between criminal proceedings in the United Kingdom and proceedings abroad. The privilege could not automatically be claimed as regards foreign proceedings, but the court had discretion as to whether to grant the protection.

Secondly, he agreed that although the privilege had not been raised before the High Court, it could have been claimed in the future and that possibility was a factor to be considered in deciding whether to make an order.

Lord Justice Pill then analysed the judgment of the court below and noted that the judge had been aware that the defendants had not fully considered the privilege against self-incrimination. Further, the judge had been aware of the allegations of proximity between the claimant bank and the Kazakh state. He concluded

“The judge considered the relevant factors and reached a conclusion which, in my judgment, he was entitled to reach. He acknowledged the risk of prejudice to the defendants. He was not obliged to defer the obligation to make disclosure until after the [discharge] hearing...He was entitled to approve the questions...”

Lord Justice Pill also noted that an undertaking had been offered by the claimant bank that the defendants need disclose the information only to the legal teams and not to the claimant itself. In view of these points together, he proposed that the appeal be dismissed.

Lord Justice Moses agreed with that decision. Lord Justice Sedley also concurred, but added some general comments on the privilege against self-incrimination, as well as comments about the evidence before the court. As regards the privilege, Lord Justice Sedley stated that:

“...These appeals illustrate vividly the potentially stultifying effect of the privilege against self-incrimination on the administration of justice...how has an exclusionary rule designed to promote justice by preventing the use of torture or pressure to extract confessions become transmuted into a personal right which is able to defeat the ends of justice?”

Lord Justice Sedley also referred to the undertaking offered and noted that it could create significant problems, not least “because lawyers are not in the ordinary way permitted to keep relevant things secret from their clients, but also because counsel may find it necessary to make use at trial of knowledge which has been acquired subject to such an undertaking. If in such a situation application is made to the trial judge for permission to make use of it, the judge in turn will be placed in an impossible quandary.”

**Comment**

The case is good news for claimants seeking to protect and recover their assets in cases of fraud.

It would appear from their Lordships’ judgments that the Court of Appeal was not minded to overturn the decision of the High Court even in the absence of the undertaking offered by the claimant bank to confine disclosure to their solicitors and counsel. Although that undertaking appeared to solve the immediate concerns of the bank,
it presented its own problems, as identified by Lord Justice Sedley.

The case is noteworthy because of the court’s apparent irritation at the attempt to use a long-standing shield as a sword. Had the defendants succeeded with their argument, the privilege would not only have protected the defendants from their alleged concerns about Kazakh justice, but also acted as a virtual knock-out blow to the claimant’s case, thereby preventing the bank from vindicating its rights. Even if the claim were likely to be successful, it would most probably not have been worth pursuing in the absence of disclosure of the assets, or its value would at least have been severely diminished.

The case therefore shows the fine balancing act the first instance judge must conduct. Genuine concerns as to the effects of disclosure can indeed be vented before the court, which maintains discretion to refuse disclosure. Inter-solicitor correspondence can also be a forum where short-term undertakings can be sought by a defendant, but it is not realistic to bend the protection of privilege into a weapon.

Lord Justice Sedley concluded with a comment which indicated how the Court of Appeal viewed attempts to manipulate the privilege, stating:

“The fact that the claimants have been driven to offer this unsatisfactory form of confidentiality as a foil to the privilege against self-incrimination is another reason for concern at its expansion from a protection against state oppression into a fraudster’s refuge.”

Those closing words may herald further changes to the prevailing use of certain ‘rights’ in court as a defence to serious allegations.

Practical implications

The case is a useful reminder as to how toothless a freezing order will be, absent disclosure of assets by the defendant. If faced with a defendant attempting to rely on the privilege against self-incrimination, consider first where the threatened criminal proceedings would occur.

As was seen in this case, foreign proceedings provide a far less secure basis for seeking to rely on the privilege. Nevertheless, the court has a discretion to afford relief and the claimant should therefore consider offering undertakings if the risk to the defendant is indeed real.

In most cases when acting for entities unconnected to departments of state, it appears very unlikely that disclosure of assets to the claimant will itself lead to a likelihood of the defendant being prosecuted.

Even where the proceedings involve an allegedly domestic threat of prosecution, the court has demonstrated its reluctance to undermine the claimant’s entitlement to vindicate its rights. Moreover, section 13 of the Fraud Act 2006 has largely removed the defendant’s ability to rely on the privilege against self-incrimination in fraud cases and “related offences”. The defendant therefore has few places to hide. In this context, it should be noted that the appellants in the current proceedings had also sought to argue that they fell out with section 13 and could therefore rely on the privilege in protecting them against possible criminal proceedings under section 328 of the Proceeds of Crime Act. They sought to argue that the section 328 offence was not a “related offence” within the meaning of section 13(4) of the Fraud Act and therefore the privilege applied. Following Kensington International Ltd. v Congo [2007] EWCA Civ 1128, the Court of Appeal [2009] EWCA Civ 1124 dismissed this part of the appeal also, stating that the matter had to be judged by reference to the essential character of the offence, rather than the way it was committed. As the section 328 offence was essentially of a fraudulent quality, the privilege against self-incrimination was removed by the Fraud Act.

If the privilege can be relied upon, and if the risk of prosecution is genuine, short term undertakings would appear to be the optimum half way house. In both cases, however, it will be far harder for the defendant to convince the claimant or court that it is not simply seeking to avoid disclosing assets as an end in itself. If acting for a defendant, suggesting up front that the claimant provide undertakings might appear to be the most efficient way of avoiding costly interlocutory battles. A solicitor in that position should always satisfy himself that the alleged risk of his client being prosecuted is indeed real rather than a purely tactical step.

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The difficulty of establishing unlawful means conspiracy

Overview

The decision of the High Court in Bank of Tokyo-Mitsubishi UFJ Ltd. and another v. Baskan Gıda Sanayi ve Pazarlama AS and others [2009] EWHC 1276 (Ch.) highlights the difficulty of establishing liability in the tort of conspiracy to injure by unlawful means. The case is likely to be topical in the current economic climate where a primary defendant in a fraud case is insolvent and there follows the inevitable hunt for deep-pocketed third parties. In such circumstances, the list of key targets is often extended through the use of accessory liability torts, such as dishonest assistance or knowing receipt, which are dependent on establishing a breach of trust or fiduciary duty on the part of the primary defendant. Where such a breach cannot be established because the defendant is not in the position of a fiduciary, seeking to demonstrate a conspiracy may be the only route open to the claimant.

Establishing liability against alleged co-conspirators can, however, be extremely difficult, as demonstrated by this case. Although “unlawful means conspiracy”, as it is known, can be relatively straightforward to establish where there is evidence that co-conspirators have designed and implemented a common cause from the outset, problems arise for the claimant where a core defendant designs the fraud and engages a third party to assist with its implementation. The third party can quickly become mired in the intricacies of the fraud, but unless it knew of the fraud and intended to harm the claimant, bringing a successful case against the third party will be challenging; indeed, if the third party did not know of the fraud and/or intend to harm the claimant bringing a successful claim will be impossible, as this case demonstrates.

Whilst the judge in this case provided a thorough and legally sound analysis, the decision shows that cases of unlawful means conspiracy can lead to apparently unfair results for defrauded creditors who are often faced with a bankrupt fraudster and have nowhere to turn to satisfy the claim. The judgment is extremely lengthy and detailed; this short article concentrates only on the court’s analysis of the law relating to unlawful means conspiracy.

Facts

The claimant banks had advanced rolling trade finance to the lead defendant (“Baskan”), a Turkish nut exporter. Baskan undertook to repay the finance by way of assignment of monies due from one of the principal purchasers of its nuts, the Ferrero group (“Ferrero”). After drawing down funds in the sum of €22.8 million, Baskan transferred the entirety of its assets, business, premises and employees to a separate company. Baskan then ceased trading and defaulted on its repayment obligation to the banks. It had at that stage repaid around €1.4 million to the banks, leaving a net shortfall of around €21.4 million.

The banks contended (and the judge noted that this was “not seriously in dispute between the active participants in this litigation”) that they were the victims of a premeditated fraud by Baskan and its controlling family.

The claimants sought to recover the sums from Ferrero, on several grounds. This article concerns the allegation of unlawful means conspiracy for Ferrero’s alleged role in Baskan’s fraud against the banks. Although the banks were successful in part on their other heads of liability, their claim based on unlawful means conspiracy failed.

Decision

In a thorough and detailed judgment, Mr. Justice Briggs outlined the ingredients of the tort of unlawful means conspiracy. The starting point in such a case is the requirement to demonstrate that the defendant had an intention to injure the claimant by unlawful means. In other words, the banks would need to prove that Ferrero shared a common objective with the primary fraudster, Baskan, to injure the banks. It would also need to be shown that Ferrero knew that this harm would be achieved by the unlawful means intended to injure the banks.

Intention to injure

The judge analysed the leading authority on intention to injure, OBG Ltd. v. Allan [2007] UKHL 21, which contains the following comment by Lord Nicholls:

“A high degree of blameworthiness is called for, because intention serves as the factor which justifies imposing
liability on the defendant for loss caused by a wrong otherwise not actionable by the claimant against the defendant. The defendant’s conduct in relation to the loss must be deliberate. In particular, a defendant’s foresight that his unlawful conduct may or will probably damage the claimant cannot be equated with intention for this purpose. The defendant must intend to injure the claimant.”

OBG related to the torts of inducing breach of contract and causing loss by unlawful means, whose components closely mirror those of unlawful means conspiracy, and were therefore accepted by the Court of Appeal in Meretz Investments NV v. ACP Ltd. [2008] Ch. 244 as fully applicable to the case of conspiracy to injure by unlawful means.

In OBG Lord Nicholls commented that a defendant might seek to harm the claimant’s business either as an end in itself (where, for example, he had a personal grudge against the claimant) or as a means to an end (for example, to promote his own business interests). In each of these situations the intentional harm inflicted on the claimant would satisfy the “intention” of the tort, even if the harm was inflicted simply because the defendant would have preferred the claimant not to be standing in his way.

Although the court in OBG held that to satisfy the requirement of “intention” it was not enough that harm was one foreseeable consequence of the defendant’s actions, the “intention” could be the “obverse side of the coin” (as the court termed it) from the defendant’s conduct. Lord Hoffmann stated in OBG:

“Take a case where a defendant seeks to advance his own business by pursuing a course of conduct which he knows will, in the very nature of things, necessarily be injurious to the claimant. In other words, a case where loss to the claimant is the observe side of the coin from gain to the defendant. The defendant’s gain and the claimant’s loss are, to the defendant’s knowledge, inseparably linked. The defendant cannot obtain the one without bringing about the other. If the defendant goes ahead in such a case in order to obtain the gain he seeks, his state of mind will satisfy the mental ingredient of the unlawful interference tort.”

Unlawful means

Citing Meretz as authority, the judge in the current case therefore held that the defendant must know that the claimant’s loss would be caused by the unlawful means; a defendant will not be liable if he believes that he has a lawful right to do what he is doing. Accordingly, for Ferrero to be liable, the banks had to show that Ferrero and Baskan had a common intention to harm the banks by way of something unlawful – i.e. Baskan’s fraud. To prove this, the banks would have to show that Ferrero knew of Baskan’s fraud.

The need to show that the defendant knew that: (1) the conduct was unlawful; and (2) the unlawful aspect of the conduct would cause loss to the claimant, requires, the judge said, an analysis of both the quality and the extent of the defendant’s knowledge.

Considering first the quality of the knowledge, the judge held that the starting point was the judgment of the House of Lords in Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd [2003] 1 AC 469. (Although given in a different context, the analysis in that case was approved by the Court of Appeal in Attorney General of Zambia v Meer Care & Desai [2008] EWCA Civ 875 as applying equally to the torts of dishonest assistance and unlawful means conspiracy.) Knowledge includes “blind eye” or “Nelsonian” knowledge which, the judge concluded, requires that the defendant believed it likely (rather than merely suspected) that the conduct was unlawful and would cause loss to the claimant, and refrained from inquiring in order to avoid confirming the truth.

Further, citing the Court of Appeal’s judgment in Hain v Jyske Bank (Gibraltar) Ltd [1999] Lloyd’s LR 511, it was not sufficient that a reasonable person ought to have drawn the inference that it was likely the conduct was unlawful; it must be established that the defendant did indeed draw that inference.

As regards the extent of the knowledge, the question was how much of the principal fraudster’s scheme the defendant would need to know before incurring liability for the consequences of the fraud. The judge noted that there were issues “where primary fraudsters (here the Baskans) have invited others to assist them in their dishonest designs on a strict ‘need to know’ basis.” The judge noted apparently conflicting dicta in the authorities and stated that the answer lay “…in a painstaking analysis
of the extent to which the particular defendant shared a common objective with the primary fraudsters, and the extent to which the achievement of that objective was to the particular defendant’s knowledge to be achieved by unlawful means intended to injure the claimant.”

Analysis

Undertaking such a “painstaking” analysis, the judge concluded that “none of those events, taken singly or together, justify or even support an inference of dishonest participation by Ferrero in a conspiracy to defraud the Banks”. In reaching this conclusion Briggs J carried out a careful analysis of the extent to which Ferrero shared a common objective with the primary fraudsters, and the extent to which that objective was, to Ferrero’s knowledge, to be achieved by unlawful means intended to injure the claimants. In doing so, the court took a wide range of circumstances into account, including Ferrero’s long-standing (and trouble free) relationship of trust with Baskan, and the lack of any motive for Ferrero to participate in such a fraud. The court found that Ferrero’s common objective with Baskan had not been the defeating of claims of Baskan’s creditors as a class, and as such, the conspiracy claim against Ferrero failed. The claimants had therefore not established the requisite “intention” on the part of Ferrero, as whilst Ferrero had been aware of certain facts relevant to the alleged fraud, they had not known the entirety of the facts relating to the planned fraud, particularly the aspects that caused much of the banks’ loss.

Comment

The outcome of the case might appear harsh for a party who, through no failure of its own, is unable to recover from an insolvent fraudster or third parties engaged to assist with the fraud. When one considers, however, that such cases are seeking to establish that a party which has not itself committed fraud should nonetheless be held liable for its consequences, it is perhaps not surprising that the courts require an extensive analysis of the facts and a finding of a “high degree of blameworthiness” by that defendant.

Whilst this case does not establish new law, it does demonstrate, to quote the judge, how painstaking the factual analysis is required to be to establish liability on the part of an alleged conspirator. It also demonstrates how fastidious counterparties, such as banks, need to be with reviewing the audited accounts of borrowers: in this case, the judge commented that the banks’ failure to study the audited accounts properly “was seriously blameworthy”.

The only practical solution to dealing with any counterparty, such as a borrower, is to insist on and take into account regular audits of the borrower, and a regular rotation of auditors, to maximise the protection for the lender bank. Elementary though that may seem, it is surprising how relaxed the auditing regime in non-listed companies can become. It is in the interests of any large lender to ensure it insists on auditing the borrower’s auditors, and ensuring that no comfort zone builds up between the borrower and its auditor.

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