Stanford, Liquidations and the Serious Fraud Office

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Steven D. Richards

In relation to insolvent liquidations under U.K. law, one of the primary objectives will be the implementation of an efficient process to preserve and recover assets for the benefit of the creditors. This is particularly so where there is a need to instigate costly litigation or cross-border recognition proceedings and where the liquidator will want increased assurances as to the likelihood that those steps will generate positive returns. Difficulties can arise, however, where—as is often the case when fraud has contributed to the insolvency—criminal investigations are being conducted in parallel to the liquidation proceedings. In those circumstances, the criminal process is often afforded a priority, which can have a prejudicial effect on civil recovery actions and the liquidation process generally. In this article, we take a brief look at the interaction between insolvency and criminal proceedings in the context of the recent decision of the U.K. Court of Appeal in *Re Stanford International Bank Ltd (In Liquidation)* [2010] EWCA Civ 137.

Competing Steps by the Serious Fraud Office

Suppose an English company, "Trading Limited," is wound up by an order of the English Courts. On appointment, the liquidators discover that substantially all of the assets of Trading Limited are in the form of deposits with banks situated in England. But what if evidence is then

uncovered which suggests that Trading Limited has been used as a vehicle for money laundering, such that there are grounds to believe that the bank accounts in question have received proceeds of crime? In those circumstances, the liquidator may well ask himself whether his efforts to recover assets for the benefit of the general body of creditors could be prejudiced by steps taken by the Serious Fraud Office ("SFO") to take control of the tainted funds.

Before addressing this issue, it is first necessary to consider the types of orders that can be granted to the SFO (or other relevant prosecutors) by the English Criminal Courts.

1. *Domestic Restraint Order*: Akin to a civil freezing injunction, an English restraint order—granted pursuant to s.41 of the Proceeds of Crime Act 2002 ("POCA 2002")—is an anticipatory and protective measure designed for the purpose of "prohibiting any specified person from dealing with any realisable property held by him" (s.41.1) with a view to preserving assets against the possibility of a future confiscation order (discussed below). The specified person need not be an actual or potential defendant. To obtain a restraint order, the SFO must be able to demonstrate that, without it, there is a reasonable chance that the property would be dissipated (this may be inferred from the circumstances of the alleged offence) and that one of the statutory conditions has been met. These conditions include showing that a criminal investigation has been started in England and Wales and that there is reasonable cause to believe that the alleged defendant has benefited from his criminal conduct.

2. *External Restraint Order ("ERO")*: This is a restraint order applied for by the SFO following receipt of a request for assistance from an overseas authority (for example, the U.S. Department of Justice). The jurisdiction to grant an ERO is founded in s.444 of POCA 2002, as exercised by the Proceeds of Crime Act 2002 (External Requests and Orders) Order 2005 SI No: 3181 (the "ERO Act"). In cases involving external requests for the restraint of identified property, what matters is whether the foreign jurisdiction may make an order in relation to the property in question, so that there are reasonable grounds for believing that an ERO may be needed to satisfy a foreign confiscation order.

3. *Confiscation Order*: Once a defendant is convicted of a criminal offence, the prosecutor or the court may initiate a confiscation process. POCA 2002 provides for the confiscation of the defendant's "benefit" from the criminal conduct of which he has been convicted, and also from his general criminal conduct. The court must make a confiscation order if the defendant is found to have a criminal lifestyle and to have benefited from his general criminal conduct or from the specific criminal conduct giving rise to the prosecution. Any such confiscated proceeds will be paid to the SFO.

4. *Compensation Order*: If there are victims who have started or intend to start civil proceedings in respect of loss, injury or damage sustained in connection with the fraud, the court has the discretion to make an order compensating those victims, as an alternative or in addition to granting a confiscation order. The court will do so if it considers on public-policy grounds that a payment by way of compensation is more

> equitable in redistributing the misappropriated benefit to those who have suffered loss. If the defendant does not have the requisite funds to meet the terms of both the confiscation order and the compensation order, the compensation sums will take priority. It is not a prerequisite to making a compensation order that the defendant would be civilly liable for the loss.

In the scenario described above, assume also that the SFO applies for and obtains a restraint order which has the effect of prohibiting dealings with the funds held in the accounts on behalf of Trading Limited. Does this mean therefore that the liquidator of Trading Limited cannot take control of and realise those same funds? The answer depends on whether the restraint order was granted before or after the date of the winding-up order for the liquidation. If granted first, the restraint order takes priority; if it is granted second, the liquidation prevails. This is the effect of s.426 of POCA 2002. In other words, in the case of domestic insolvencies, a liquidator's ability to deal with assets will be fettered only by a restraint order granted before his appointment. The policy behind this rule appears to be to stop a defendant in criminal proceedings from using an insolvency—commenced after a restraint order has been granted—to defeat that restraint order.

Foreign Considerations

It is important to note that s.426 of POCA 2002 does not apply to either an ERO or insolvency proceedings other than those governed by the laws of England, Wales or Scotland. Therefore, the usual rule on priority will not apply where a restraint order prohibits dealings in assets which are also the subject of insolvency proceedings commenced by way of an order of a foreign court. In

those circumstances, what is the effect of a restraint order, and in particular one obtained after the date of commencement of the foreign liquidation, on the ability of the insolvency officeholder (*e.g.*, trustee, administrator, receiver, liquidator or other insolvency representative) to realise the assets in this jurisdiction? This was one of the issues before the Court of Appeal in *Stanford*.

Stanford **Facts**

At this stage, it would be useful to summarise the somewhat complicated procedural background to the *Stanford* matter.

1. Stanford International Bank ("SIB") was incorporated in Antigua in 1990. In 2009, allegations surfaced to the effect that SIB was involved in a "Ponzi" scheme orchestrated by Sir Allen Stanford and other associated individuals. On this basis, the U.S. Securities and Exchange Commission applied successfully to a U.S. District Court in Texas on 16 February 2009 for an order appointing a receiver (the "U.S. Receiver") over the assets of SIB, Allen Stanford and other individuals.

2. On 19 February 2009, the Financial Services Regulatory Commission of Antigua (the "FSRC") nominated Peter Wastell and Nigel Hamilton-Smith as joint receiver-managers of SIB.

3. On 26 February 2009, the FSRC applied successfully to the Court of Antigua for an order appointing Mr. Wastell and Mr. Hamilton-Smith as the joint receiver-managers of SIB. In March 2009, the FSRC then presented a petition to the Antiguan High Court for the

compulsory winding up of SIB and, on 15 April 2009, an order was made for the liquidation of SIB and for the appointment of Mr. Wastell and Mr. Hamilton-Smith as its joint liquidators (the "Antiguan Liquidators"). Pursuant to the terms of that order, all of the assets of SIB wherever situated were vested in the Antiguan Liquidators.

4. Prior to the Antiguan liquidation order, on 6 April 2009, the U.S. Department of Justice (the "USDOJ") had sent a letter of request pursuant to the U.S./U.K. Mutual Assistance in Criminal Matters Treaty requesting the immediate assistance of the U.K. in relation to an investigation being carried out by the USDOJ in respect of the Stanford fraud. This letter requested the restraint of all assets in the U.K. of SIB, Allen Stanford and other individuals so that those assets might be secured for confiscation at a later date.

5. On 7 April 2009, the SFO dealt with the USDOJ's letter of request by applying (*ex parte*) to the Central Criminal Court in London for an ERO in respect of the assets identified in the letter of request. That application was successful and a restraint order was granted.

6. Meanwhile, the Antiguan Liquidators had identified the existence of assets of SIB held by various financial institutions in England. On 22 April 2009, the Antiguan Liquidators applied to the High Court in England under Article 15 of the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law")—implemented in the U.K. pursuant to the Cross-Border Insolvency Regulations 2006—for an order for recognition of the Antiguan

liquidation of SIB (together with an order entrusting the distribution of the assets of SIB situated in Great Britain to the Antiguan Liquidators).

7. On 8 May 2009, the U.S. Receiver also applied to the High Court in England for recognition of the U.S. receivership of SIB (again under the Model Law).

8. The competing recognition applications of the Antiguan Liquidators and the U.S. Receiver were heard in June 2009 by Mr. Justice Lewison (who was not informed about the existence of the restraint order that had been granted in April 2009). Mr. Justice Lewison accepted the application of the Antiguan Liquidators and dismissed that of the U.S. Receiver. In giving judgment, Mr. Justice Lewison said that the Antiguan Liquidators were entitled to take control of the assets of SIB in the U.K., but that this right was stayed pending an appeal by the U.S. Receiver. The Antiguan Liquidators requested, therefore, that a portion of the assets be released to allow them to fund the ongoing costs of the liquidation in Antigua pending the hearing of the appeal. This request was allowed subject to, amongst other things, the Antiguan Liquidators' being able to overturn the restraint order that had been granted to the SFO in April 2009.

9. The Antiguan Liquidators then applied to the Central Criminal Court in London on 17 July 2009 for a variation of the restraint order to enable the directions of Mr. Justice Lewison to be carried out. On the morning of the hearing of that application, the

Antiguan Liquidators were served with the evidence that had been submitted on behalf of the SFO in support of its original application in April 2009 for a restraint order. On the basis of this evidence, the Antiguan Liquidators amended their application to include an alternative request for the discharge of the restraint order (on the grounds of misrepresentation and material nondisclosure at the hearing in April 2009).

10. This application to vary or discharge the restraint order was heard on 24 July 2009. In giving judgment on 29 July 2009, the Court refused to vary or discharge the restraint order but granted permission to appeal to the Antiguan Liquidators.

Stanford: **Court of Appeal Decision**

Against this background, the Court of Appeal was asked to determine, amongst other things, two related appeals: (i) the appeal of the U.S. Receiver from the order of Mr. Justice Lewison dismissing the U.S. Receiver's recognition application; and (ii) the appeal of the Antiguan Liquidators from the order of the Criminal Court refusing to vary or discharge the restraint order.

The subsequent decision by the Court of Appeal in *Stanford* is important for two reasons. Firstly, in relation to the appeal from Mr. Justice Lewison, the Court held that the U.S. receivership was not a "foreign proceeding" within the meaning of that expression as defined in Article 2(1) of the Model Law (and that the Antiguan liquidation was a foreign proceeding). In doing so, the Court of Appeal clarified the test to be applied for determining a company's centre of main interest, or

"COMI"; it held that the key test is that the COMI must be ascertainable by third parties by virtue of the facts and circumstances of the debtor which are in the public domain or which a typical third party would learn as a result of dealing with the debtor in the ordinary course of its business. Applying that test in *Stanford*, the COMI of SIB was held to be Antigua.

Secondly, the Court of Appeal held that: (i) there had been material misrepresentation and nondisclosure by the SFO and the USDOJ on the *ex parte* application for the restraint order on 7 April 2009; (ii) the restraint order made on that date should therefore be set aside; and (iii) the restraint order should be granted afresh with effect from 29 July 2009. What this meant was that the new restraint order was later in time than the date on which SIB was wound up by the Antiguan courts. So far, so good for the Antiguan Liquidators.

But the Court of Appeal then went on to consider whether the restraint order nevertheless had administrative priority over the Antiguan liquidation. The Court of Appeal held that it did. In reaching this conclusion, the Court of Appeal relied on, amongst other things, what was referred to as the "legislative steer"—contained in Article 46(1)–(3) of the ERO Act (reproducing s.69(1)–(3) of POCA 2002)—which states, amongst other things, that the power to grant an ERO must be exercised "with a view to securing that there is no diminution in the value of the property identified in the external request" (Article 46(2)(b)). Applying this guidance, the Court of Appeal—having decided that references to "property" held by SIB included references to property vested in the Antiguan Liquidators—held that it was necessary to grant a restraint order on 29 July 2009 in order to stop, for the time being, the risk of diminution in the value of the

deposits held with the specified banks in the name of SIB in paying the costs of the Antiguan liquidation proceedings. Accordingly, the Court of Appeal held that it followed from the grant of this restraint order that administrative priority over the assets in England was conferred on the SFO/USDOJ.

Stanford **Consequences**

In the circumstances, the effect of *Stanford* appears to be that—where s.426 of POCA 2002 does not apply—a restraint order will take precedence over competing liquidation proceedings and, in turn, the powers conferred on the liquidator, irrespective of whether the restraint order was obtained before or after the date of the winding-up order.

The *Stanford* decision will not be welcomed by either officeholders or creditors. Firstly, the Court of Appeal justified its decision by reference to the fact that the SFO/USDOJ, whose aim was to recompense the victims of the fraud, would carry out their functions at the public expense, and that the funds available for distribution would not be eroded therefore by the costs of the Antiguan Liquidators. However, there may well be creditors of SIB who are not "victims" for the purposes of any public distribution. Any such creditors would end up empty-handed.

Secondly, the process of identifying foreign assets and obtaining cross-border recognition orders can be time-consuming and expensive. If the officeholder knows that a restraint order has been granted, or that the SFO intends to make an application for a restraint order, advice can be taken in advance by the officeholder as to whether that restraint order would take priority. In turn, this

will inform the decision as to whether the grant of a recognition order would serve any practical purpose. But the SFO may not be willing to disclose its intentions in this regard or may not have made any decision at that time about the need for a restraint order. In those circumstances, the liquidator would risk wasting significant resources in the event that his attempts to obtain foreign recognition—even if successful—were then trumped by a late request to or decision by the SFO to apply for a restraint order over the same assets. This places the liquidator in a very difficult position.

Thirdly, the result in *Stanford* would have been different if SIB had been wound up under the Insolvency Act 1986 and the SFO had applied for a domestic restraint order. In other words, in the event that the fraud had been perpetrated within the confines of the U.K., the restraint order would not have taken priority over the insolvency proceedings and the liquidators of SIB would have had the ability to realise the assets in question. This is an artificial and inconsistent approach, and English law should afford equal protection to the creditors of both domestic and foreign insolvencies. Subject therefore to any appeal to the U.K. Supreme Court, such inconsistency may be remedied only through legislative intervention.