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Frozen out: The importance of complying with the duty of full and frank disclosure when applying for a freezing injunction

Introduction

In this alert we consider the recent Commercial Court judgment in *Banca Turco Romana SA v Cortuk & Ors*[1] which concerned applications for freezing orders against third parties to a fraud claim. The freezing injunctions were set aside on the basis of a number of material non-disclosures made by the applicant.

This decision by Popplewell J underscores the importance of complying with the obligation of full and frank disclosure when applying for a freezing injunction on an *ex parte*[2] basis. Failure to do so could result in the injunction being discharged. In light of the cross-undertaking in damages an applicant has to give when applying for an injunction, this then opens the applicant up to potentially significant liabilities to compensate the respondents for any losses suffered by the freezing injunction being granted in the first place.

Background

This judgement concerned an application made by Banca Turco Romana S.A. (**"BTR"**), acting by its liquidator Fondul de Garantare a Depozitelor Bancare, to make final the interim freezing orders granted at an ex parte hearing on 16 November 2017. From 1993 until 2002, when it was put into liquidation, BTR was a large retail and commercial bank with operations chiefly in Romania. It was closely associated with, and majority owned by a group of companies of which Mr Cortuk (the **"Defendant"**) is the owner and controller.

The interim freezing order against the Defendant was granted pursuant to substantive proceedings to enforce a judgment obtained against him in Romania.

This judgment was for fraud in civil and criminal proceedings, pursuant to which (a) BTR was awarded approximately US$59.4million and €11.3million plus interest, and (b) the Defendant was sentenced to 13 years imprisonment (the **"Romanian Judgment"**).

Interim freezing orders were also granted against four third parties, Mr Serkan Cortuk (the Defendant's son), Ms Sakarya, Mr Özerman and Ms Gönen. They were joined as non-cause of action defendants to the application as they were said to have assisted the Defendant in concealing his assets.

The Defendant and Mr Serkan Cortuk played no part in the freezing order proceedings, such that the orders against them were continued. The issue before the court was whether or not to continue the interim freezing injunctions granted against Ms Sakarya, Mr Özerman and Ms Gönen.

The assets and multiple proceedings

There were three groups of assets over which freezing orders were sought: the Rowena structure; the Tempus structure; and a life insurance policy in favour of Ms Gönen.

The Rowena structure comprised a corporate structure spread across multiple jurisdictions with substantial assets located in (it was assumed) New Jersey, USA. This corporate structure included an English company (**"Westpoint UK"**) which was the 100% owner of a US company which held the assets. Ms Sakarya alleged that she was the ultimate beneficial owner of the ultimate parent company, and accordingly of the assets in the Rowena structure. BTR alleged that in fact the Defendant was the beneficial owner of the Rowena structure and, therefore, the assets in it.

1 [2018] EWHC 662 (Comm).

2 I.e. an application "without notice", with only the applicant present at the hearing.

The Tempus structure comprised a Liechtenstein foundation, ultimately beneficially owned by the Defendant, with subsidiaries – including a company incorporated in Malta called Teneo Holdings Ltd (**"Teneo"**) – which hold valuable real estate assets in Romania. BTR alleged that some of the real estate in Romania had been purchased with the proceeds of a fraud that the Defendant perpetrated on BTR, in which real estate had been purchased at an alleged overvalue of US$5.5 million.

The life insurance policy was purchased by Ms Gönen, with the Defendant as an alternate beneficiary, and was redeemed by Ms Gönen in part in 2012 and in full in 2013. The proceeds of such redemption were paid to Teneo. BTR alleged that Ms Gönen purchased the policy with the Defendant's funds, and did so on his behalf; and that the proceeds from the redemption of the policy were paid for the Defendant's benefit.

BTR is pursuing various proceedings around the world, namely:

(a) proceedings in England to enforce the Romanian Judgment,[3] pursuant to which the injunctions had been sought;

(b) the liquidation of BTR in Romania;

(c) bankruptcy proceedings against the Defendant in New Jersey, USA (the **"New Jersey proceedings"**); and

(d) enforcement proceedings in Switzerland to enforce the Romanian Judgment (the **"Swiss proceedings"**).

The New Jersey proceedings concerned, first, a declaration that Westpoint UK was a sham company such that Westpoint UK's property should be subject to execution by BTR, and, second, a claim to "unwind" an allegedly fraudulent transfer of a specific property. On the basis that the claim as to the property was adequately protected by the New Jersey proceedings, this was carved out from the scope of the interim freezing orders granted by the English court.

The Swiss proceedings concerned criminal money laundering proceedings which were settled by way of a confidential settlement agreement. Pursuant to that agreement the Defendant forfeited CHF 2.8 million to BTR without accepting any criminal or civil liability.

However, BTR have an ongoing claim for the recognition and enforcement of the Romanian Judgement in Switzerland.

At the *inter partes*[4] hearing on 22 and 23 March 2018 the freezing orders against Ms Sakarya, were set aside due to the applicant's "*substantial and serious*"[5] breaches of its obligation of full and frank disclosure.

The duty of full and frank disclosure

An applicant for a freezing order has a duty to make full and frank disclosure of all matters that are material to the court. The applicant must present the evidence and the case in an even-handed manner, to promote both its own arguments and those which it can reasonably anticipate the respondent would make.[6]

This arises from the fact that the initial hearing for the grant of such an order is *ex parte*, that is to say, the applicant appears alone and without notice to the other parties. In his judgement, Popplewell J described the duty of disclosure as being "*the necessary corollary of the court being prepared to depart from the principle that it will hear both sides before reaching a decision, which is a basic principle of fairness*".[7]

Breaches of the duty of full and frank disclosure

Popplewell J found that the duty of full and frank disclosure was breached by BTR by way of a number of material misrepresentations and non-disclosures in its application for the freezing orders against Ms Sakarya, Mr Özerman and Ms Gönen.

THE NEW JERSEY PROCEEDINGS

The New Jersey proceedings were mischaracterized as being solely concerned with the fraudulent sale of a specific property – no mention was made of BTR's claim in relation to Westpoint UK and, therefore, its attempt to use the courts of New Jersey, USA to enforce against assets within the Rowena structure. This overlapped with the English enforcement proceedings and undermined BTR's grounds for arguing that the England was the appropriate jurisdiction in which to enforce the Romanian Judgment.

3 The Romanian Judgment had been recognised and registered for enforcement in the courts of England on 28 November 2017 by Master Kay QC.

4 A hearing with all parties present and able to make representations.
5 Paragraph 46.
6 Paragraph 45.
7 Paragraph 45.

This *"true but incomplete description"* as to the nature of the proceedings was *"maintained but not corrected"* in the skeleton argument for the hearing itself[8] and continued at the *ex parte* hearing when BTR's counsel stated that England was the only place where the judgement was being enforced and that no other substantive proceedings were ongoing. Popplewell J characterised these breaches as not only BTR presenting the court with "*positive misrepresentations*" but also *"failing by its omissions to give a fair picture to the court"*.[9]

The respondents had pointed out these breaches to BTR in correspondence and evidence prior to the *inter partes* hearing, as well as in argument at the hearing itself. Despite this, BTR did not take the opportunity to correct its failings and did not provide any explanation as to why it did not do so. As a result Popplewell J found that BTR's conduct in breaching its duty of full and frank disclosure in this respect was deliberate.[10]

THE SWISS PROCEEDINGS

As noted above, BTR had alleged at the *ex parte* hearing that England was the only jurisdiction where the Romanian Judgement was being enforced; however this was *"untrue"* not only in light of the New Jersey proceedings but also because the Swiss proceedings were ongoing.[11]

In addition, the witness evidence presented at the *ex parte* hearing misrepresented the position in relation to the nature and confidentiality of the Swiss settlement. BTR had submitted that the money recovered under the Swiss proceedings was the proceeds of crime – however this was not true. The settlement in the Swiss proceedings had been expressly agreed on the basis that there was no admission as to this point.

In an attempt to explain the failure to disclose the terms of the settlement agreement, BTR submitted that it could not refer to the existence of the agreement due to the confidentiality provisions in it. However Popplewell J considered that it was necessary to refer to the Swiss proceedings for the purposes of BTR's application, and so the duty of full and frank disclosure arose. Importantly, he found that the confidentiality provisions were no impediment to disclosing the existence and nature of the settlement agreement, as such disclosure was required by law.

Again, no explanation was given as to why the Swiss settlement was not referred to at the hearing and no explanation was given for the misrepresentation of the funds.

THE TEMPUS STRUCTURE

A further breach of the duty of disclosure took place due to a failure to draw the court's attention to a weakness in BTR's case in respect of the alleged fraudulent transfer of a property held in the Tempus structure. BTR failed to explain that an "*extraordinary valuation method was used*"[12] to argue that property was sold at an overvalue, which gave rise to the allegation of fraud. BTR also failed to draw the court's attention to the relevant sections of the valuation report. Popplewell J found that "*the failure to explain the valuation methodology and draw attention to the relevant part of the report [was] a breach of the duty of full and frank disclosure*".[13]

THE INSURANCE POLICY

It emerged at the *inter partes* stage that the Swiss regulator had said that it had no concerns about Ms Gönen redeeming the insurance policy, and that the policy issuer had "*applied its mind carefully*" to whether there was any regulatory concern as to the source of funds used to purchase the life insurance policy and had concluded there were not. This was apparent from a document prepared by the policy issuer.

However, not only had BTR failed to draw the conclusion of the policy issuer to the attention of the court in principle but it had failed to exhibit to its witness evidence the relevant page of the document prepared by the policy issuer setting out its conclusion on this issue, even though it had exhibited other pages from the document.

Therefore, as well as finding that this was "*a significant breach of the duty of full and frank disclosure*", Popplewell J also inferred that the "*suppression of the document was deliberate*".[14]

CONCLUSION

Although Popplewell J recognised that there could be "*rare cases where the merits of the application are overwhelming and justice cries out for the continuation of the freezing relief*"[15] notwithstanding a breach of the duty of full and frank disclosure, this was not one of those cases. He therefore found that the circumstances in this case required that the freezing orders against Ms Sakarya, Mr Özerman and Ms Gönen be set aside.

8 Paragraph 31(4).
9 Paragraph 32.
10 Paragraph 34.
11 Paragraph 36.
12 Paragraph 40.
13 Paragraph 40.
14 Paragraph 43.
15 Paragraph 46.

Comment

This decision highlights the importance of an applicant complying with the duty of full and frank disclosure when applying for a freezing order.

Failure to comply with this duty can result in the interim freezing order granted at the *ex parte* hearing being set aside at the subsequent *inter partes* hearing, regardless of the merits of the application itself. In light of the cross-undertaking in damages an applicant has to give when applying for an injunction, this then opens the applicant up to potentially significant liabilities to compensate the respondents for any losses suffered by the interim freezing injunction being granted.

The applicant must draw to the court's attention any argument it can reasonably be expected the respondent would make in opposition to the application. This means that the applicant will have to include in its application evidence which it is reasonably expected the respondent would want to be included. It also means drawing the court's attention to specific points in that evidence which the respondent would reasonably want highlighted.

Finally, this judgment is also a reminder that should an applicant give a misleading impression or fail to disclose a relevant detail in application, it is important to take the opportunity to correct this as soon as possible so as to avoid the inference being drawn that the non-disclosure is deliberate. If possible, this should be supported by an explanation as to why the true position was not presented initially.

If you have any questions or comments in relation to the above, please contact the authors or your usual Mayer Brown contact.

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