Loophole in freezing order closed off

December 2015

Hogan Lovells' London litigation team has secured a landmark victory in the UK Supreme Court, closing off a loophole in the English standard form freezing order.

The UK Supreme Court held that defendants subject to an English freezing order will no longer be able to direct the payment of loan proceeds, *even if those monies never come into their own hands*, as those proceeds are "assets" within the meaning of the freezing order.

Although the wording of the Hong Kong standard form freezing order differs from the English wording, this robust and pragmatic decision safeguarding the effectiveness of the freezing order regime provides useful guidance that, in appropriate cases, the Hong Kong courts can be asked to ensure Hong Kong freezing orders apply the intended effect of the English standard form.

In "the absence of good reason to the contrary" the Hong Kong court rules require the court's standard form freezing order wording to be used. However, this case and the suggestion that assets may be dissipated in this way by an unscrupulous defendant, could provide "good reason" to request the Hong Kong court to include additional wording similar to the English standard form wording, which would include proceeds of a loan in the definition of "asset".

One of the largest frauds in history

When BTA Bank, one of Kazakhstan's largest systemic banks, discovered a multi-billion dollar black hole at the heart of its accounts in 2009, it instructed Hogan Lovells to bring claims against its former chairman, Mukhtar Ablyazov - who had fled from Kazakhstan to take up residence in London - on the basis that he had committed one of the largest frauds in history.

The first step we took was to obtain a worldwide freezing order from the English Commercial Court to lock down Mr Ablyazov's assets pending trial of BTA's multiple claims against him.

That freezing order has, in various iterations, helped hold the ring around assets stolen from BTA whilst the claims have played out in the courts. As of today, Hogan Lovells has obtained judgments against Ablyazov in BTA's favour totalling in excess of US$4.5 billion.

Using loans to side-step a freezing order

The existence of the freezing order over Mr Ablyazov's assets has generated a litany of satellite litigation over the past few years, and has led to more than 50 decisions in the English High Court and Court of Appeal. In October, one long-running dispute over the scope of the standard form freezing order was finally - and unanimously - resolved by the UK Supreme Court, giving renewed clarity to the funding arrangements that can be put in place by a defendant and the ways in which those arrangements are restricted and monitored.

In this instance, after the freezing order was put in place Mr Ablyazov took out a series of purported third party loans and ran up £40m of unsecured debt. Unbeknownst to BTA or the Court, he used these funds to pay for his own and other defendants' legal bills, as well as the up-keep of his mansion in London and the funding of various associates who were involved in the administration of his (largely undisclosed) assets.

Under the loan contracts, Mr Ablyazov had the right to direct to whom the lenders should pay the proceeds of the loans. Because the money was paid directly by the lender to the various recipients, and never came into Mr Ablyazov's own hands, he argued – and the Court at first instance and the Court of Appeal agreed – that these payments were not his "assets" for the purposes of the freezing order, meaning that they were not subject to the inherent protections and restrictions that limit a defendant's spending.

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The UK Supreme Court confirms loan proceeds can be frozen – even when they do not come into the defendant's hands

We challenged this narrow interpretation of the freezing order.

The Supreme Court considered the way assets were defined in the Ablyazov freezing order, which is in the same terms as now appear in the widely-used English standard form freezing order. This includes a provision that the defendant's "assets" for the purpose of the order *"include any asset which he has power, directly or indirectly, to dispose of or deal with as if it were his own"*, and goes on to clarify that *"The [defendant] is to be regarded as having such power if a third party holds or controls the assets in accordance with his direct or indirect instructions."*

The Supreme Court held that where a defendant is directing the payment of loan proceeds, even if those monies never come into his own hands, those proceeds are "assets" within the meaning of the English freezing order under the above "expansionary" wording – and these monies are therefore frozen on the terms of that order.

The following protections provided by the freezing order therefore bite:

- any spend on ordinary living expenses is subject to a specified weekly cap;
- any spend on the defendant's own legal advice and representation must be reasonable and must be notified to the claimant;
- money cannot be spent on anything else outside the ordinary course of the defendant's business – such as other defendants' legal costs (as was the case here); and
- because the proceeds of the loans are regarded as "assets", they become subject to the disclosure obligations imposed on the defendant – meaning he is required to inform the claimant's solicitors about them.

The Bank also invited the Supreme Court to find that Mr Ablyazov's right to draw down under the loan agreements was in and of itself an asset caught by the terms of the order, but the Court declined to take that additional step.

Another instance of the English Court strengthening the freezing order regime

The Supreme Court judgment in this case closes the loophole that previously allowed an unscrupulous defendant access to substantial funds without disclosing their existence, and without any control on how or to whom they could be dissipated. It is an innovative victory for our client, and another step forward in the significant ongoing asset recovery work.

The judgment (which can be downloaded here) has immediate relevance to freezing orders on the current English standard terms – including those that have already been made.

Hogan Lovells

Hogan Lovells' global litigation practice has acted for clients in many of the leading reported cases on freezing order jurisdiction, and our work on the BTA case alone – the largest ever fraud case in the English courts, which has resulted in a number of precedent-setting decisions – has earned us significant global recognition as a market-leading litigation firm.

If you would like to discuss any of the issues raised in this bulletin, please contact the individuals listed or your usual Hogan Lovells contact. We would be more than happy to assist.

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