Dispute Resolution

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DISPUTE RESOLUTION BULLETIN

Standard form freezing orders – conflicting decisions

Last year, Hildyard J in *Group Seven Ltd v Allied Investment Corporation Ltd & Ors* (6 June 2013) *(Group Seven Ltd)* and Burton J in *Lakatamia Shipping Company v Nobu Su & Ors* (6 June 2013) *(Lakatamia)* came to opposite conclusions as to whether assets held by companies wholly owned and controlled by a respondent are subject to the standard form of freezing order. The judgments, which are irreconcilable on this point, created worrying uncertainty for litigants, practitioners and third parties. The decision in *Lakatamia* went on appeal and the Court of Appeal's decision is now imminent. In this article, we explore the background and impact of these cases, in advance of this awaited decision.

Background

Paragraph 6 of the standard form of freezing order, which is in almost universal use amongst practitioners, provides:

"[The restriction on dealing] applies to all the Respondent's assets whether or not they are in his own name and whether they are solely or jointly owned. For the purpose of this order the Respondent's assets include any asset which he has the power, directly or indirectly, to dispose of or deal with as if it were his own. The Respondent is to be regarded as having such power if a third party holds or controls the asset in accordance with his direct or indirect instructions."

Conflicting decisions

In *Group Seven Ltd,* the defendant was the subject of a freezing order in the standard form and had listed as one of his assets a US$500,000 debt owed to a company of which he was sole shareholder and director. Without informing the claimant in advance, the company settled with the debtor for a much smaller sum. The claimant argued the defendant had breached the order by disposing, or procuring the disposal, of one of "his assets" within the meaning of Paragraph 6.

Hildyard J held that when exercising their powers, the company's decision-making bodies did not give instructions to the company as a third party. Instead, their acts were attributed to the company and they and it were as one. That a sole shareholder comprised the only decision-making body did not change this.

Therefore, when the defendant, as sole director, signed the agreement settling the debt he was the means by which the company, as an artificial creation, acted. No question of instructions being given to a third party arose: Paragraph 6 was not engaged and the freezing order was not breached.

In *Lakatamia,* the defendant was subject to a standard form freezing order and sought a declaration that assets held by companies owned and controlled by him were not subject to the restrictions in the order.

Burton J refused, identifying three reasons for concluding that Paragraph 6 did apply to assets held by companies under the defendant's control:

1. The owner of a company could direct the fate of the company's assets.
2. An owner who procured that a company dissipated its assets also diminished the value of his own assets, namely his shareholding in the company.
3. The beneficiary of a freezing order may eventually be able to enforce a judgment against a respondent's interest in a company he owns (and thereby the assets controlled by the company): this right should be protected by the order.

From a practical viewpoint the two judgments create an uncomfortable degree of uncertainty for litigants, practitioners and third parties.

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Analysis

Hildyard J's analysis is a strict one, in keeping with the court's recent acceptance of a narrower interpretation of the concept of 'piercing the corporate veil'. Burton J's judgment is a pragmatic one and probably represents the view of many practitioners.

However, Burton J's third ground in *Lakatamia* presents difficulties. It is true that the Court may grant a freezing order against a third party where there is reason to suppose that assets which are ostensibly those of the third party are, in truth, those of the defendant (commonly referred to as the "Chabra jurisdiction"). However, this involves the grant of a freezing order directly against the company, something quite different to reading an order against the respondent as automatically including his company's assets.

Impact

From a practical viewpoint, the two judgments create an uncomfortable degree of uncertainty for litigants, practitioners and third parties.

Ideally, a claimant in these circumstances would apply under the Chabra jurisdiction directly against a wholly-owned company. But claimants often apply for freezing orders with no means of knowing whether the respondent holds assets through such companies.

If *Group Seven Ltd* is correct and the freezing order does not apply to wholly-owned companies, a claimant who subsequently discovers that the respondent dissipated company assets after the freezing order was granted will have no restitution because the companies were not subject to the order when the dissipation took place. One solution – to instruct forensic accountants to expose any corporate structure in advance of an application – is expensive and may be frustrated by impenetrable corporate filings rules in some jurisdictions.

The position is no easier for third parties such as banks which are, invariably, the first port of call for a successful applicant. If non-litigants are forced to apply to court to determine to what extent they are bound by an order, the fundamental purpose of having a standard order – to allow third parties easily to determine what action is required of them – is undermined.

Hildyard J appreciated that his judgment in *Group Seven Ltd* would give cause for concern: by his reasoning, a respondent could easily neuter a standard form freezing order simply by holding his assets in a wholly-owned subsidiary. However, his decision is not subject to appeal. It is to be hoped that the Court of Appeal's decision in *Lakatamia* will bring some clarity.

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Is failure to make an advance payment on costs a repudiatory breach of an arbitration agreement?

It is not uncommon for a party to ICC arbitration proceedings (usually the respondent) to fail to make the advance payment on costs required under Article 36 of the ICC rules. What can the other party do in those circumstances?

In the recent case of *BDMS Limited v Rafael Advanced Defence Systems* (26 February 2014), the Court was asked to decide whether the respondent's refusal to pay its share of the advance on costs constituted a repudiatory breach of the agreement to arbitrate, thus allowing the claimant to bring its claim in the courts.

Background

The claimant, BDMS, brought a claim to recover unpaid success fees from the defendant, Rafael, under a consultancy agreement which contained an ICC arbitration clause.

Rafael refused to pay its share of the advance on costs unless BDMS gave security for costs as it believed that BDMS was impecunious. Shortly after Rafael had applied to the Tribunal for an order that BDMS provide security, BDMS issued a Claim Form, seeking to bring its claims against Rafael in the English Commercial Court, and applied for permission to serve out.

BDMS did not contest the fact that there was an arbitration agreement between the parties. However, it contended it was entitled to proceed in the courts because Rafael was in breach of the arbitration agreement by refusing to pay its share. That breach was sufficiently fundamental to frustrate the purpose of the arbitration agreement, constituting a repudiatory breach and rendering the agreement "inoperative". (Under Section 9(4) of the English Arbitration Act 1996, the Court was required to grant a stay of BDMS's claim unless satisfied that the arbitration agreement was "null and void, inoperative, or incapable of being performed.")

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Rafael maintained that there was no breach of the arbitration agreement, much less a repudiatory one. The arbitration agreement was not "inoperative" and the Court was obliged to grant a mandatory stay of the proceedings.

The Court's decision

The Court found there was no repudiatory breach and granted a stay of the proceedings begun by BDMS.

The Court did find that Rafael was in breach of the arbitration agreement by failing to make the advance payment. However, this did not constitute a repudiatory breach, nor did it render the arbitration agreement inoperative, for several reasons.

First, Rafael had not refused to participate in the arbitration and its refusal to pay was not absolute. Rather, it was conditional on BDMS's provision of security.

In addition, Rafael had not deprived BDMS of its right to arbitrate, as the ICC Rules provided adequate mechanisms for dealing with the situation that had arisen. These included BDMS either paying Rafael's share or posting a bank guarantee for Rafael's share; BDMS seeking an interim order or final award to compel Rafael to pay; or BDMS challenging the ICC's threat to withdraw the proceedings. Further, the ICC Rules provide that if a claim is deemed withdrawn because of a failure to pay advance costs, there is no restriction on that claim being brought in the future.

Conclusion

Although the judgment states that a party's failure to pay its share of the advance on costs constitutes a breach of the arbitration agreement, it also makes clear that it is unlikely ever to amount to a repudiatory breach. Claimants finding themselves in a position similar to BDMS are left with the fairly unattractive options of paying their opponent's share themselves, putting up a bank guarantee, or incurring costs and time to obtain an order from the Tribunal or to challenge its withdrawal of the proceedings.

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hfw Conferences and events

APRAG Melbourne
Melbourne, Australia
26–28 March 2014
Presenting: Nick Longley
Attending: Damian Honey, Chris Lockwood and Julian Sher

Asian Maritime Law and Arbitration Conference
Singapore
10–11 April 2014
Attending: Paul Aston and Paul Apostolis

Latest Developments in Anti-Corruption Legislation and Enforcement
HFW Geneva
24 April 2014
Presenting: Daniel Martin and William Hold

LCIA European Users' Council Symposium
Tylney Hall, Hampshire
9–11 May 2014

International Arbitration Seminar
HFW London
June 2014

SIAC Congress
Singapore
6 June 2014
Presenting: Chanaka Kumarasinghe

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