Keynote

The Civil Law and the Recovery of the Proceeds of Corruption and Serious Crime

With particular reference to the Republic of China

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The traditional criminal justice system in the vast majority of jurisdictions has not succeeded in effectively and efficiently depriving criminals of the benefits of their ill-gotten assets.

Nor has the traditional criminal justice system proved effective in combating serious economic crime and in particular fraud corruption.

"The public no longer believes that the … system is capable if bringing the perpetrators of serious fraud expeditiously and effectively to book … the overwhelming evidence indicates that the public are right" Lord Justice Roskill, Fraud Trial Committee (UK) 1986).

There are many reasons for this:

- Nature of economic crime and attitudes to it
- Crime of the powerful (access crimes)
- Complexity and sophistication
- Problems of securing and rendering admissible evidence
- International dimension
- Lack of resources
- Trial process
- Disproportionate benefits
- Corruption

The practical issues in tracing tainted property:

"In the course of this appeal some reference was made to the fact that assets, like the Cheshire Cat, may disappear unexpectedly. It is also to be remembered that modern technology and the ingenuity of its beneficiaries may enable assets to depart at a speed which can make any feline powers of evanescence appear to be sluggish by comparison" Derby & Co v. Wheldon (Nos 3 and 4) (1989) 2 WLR 412 at 436.

The courts must prevent *"the proceeds (or corruption) being whisked away to some Shangri-la which hides bribes and other corrupt moneys in numbered bank accounts."* Lord Templeman in AG for Hong Kong v. Reid (1994) 1 All ER 1.

Why do we wish to deprive criminals of their ill-gotten gains?

Our objectives will dictate how we go about it and influence the resources that we commit, and impact upon our expectations and measures of success (particularly important in terms of political and media credibility).

1. Criminals should not benefit from their wrongdoing
2. We should inhibit the reinvestment of criminal property back into the criminal pipeline (especially in regard to enterprise/organised crime)

"The profits made by those committing fraud and related economic crimes may be used to finance illicit trafficking or other forms of organised crime" Deputy IPG (Sri Lanka) T. Gooonatilleke, ICPO-Interpol General Assembly, Frankfurt 1972

3. We should inhibit the penetration (and possible subversion/corruption) of non-criminal businesses with the proceeds of crime (or should we focus on transparency or facilitate legitimization?)
4. Disrupt the flow of funds within structures/organisations in the hope of creating liquidity (and therefore trust related) issues
5. Facilitate recovery/restitution/compensation in regard to victims (or at least those who have a 'better' more just (sic unjust enrichment) claim (in economic terms)
6. Promote and facilitate the collection of revenue.

The United Nations Convention against Corruption

In the Preamble the significance of fighting corruption is emphasised in the context of stability, security and sustainable development. Its relationship with organised crime, economic crime and in particular money laundering is also emphasised.

The asset recovery mandate:

Article 1 ***"the purposes of this Convention are … (b) to promote, facilitate and support international cooperation and technical assistance in the prevention of and fight against corruption, including in asset recovery…"***

Article 51 ***"the return of assets pursuant to (Chapter V) is a fundamental principle of this Convention, and State Parties shall afford one another the widest measure of cooperation and assistance in this regard."***

But, in the context of the general law, what do we mean when we talk about – criminal property let alone dirty money?

- The instrumentalities of the crime
- Merely the profits of crime (may be constitutional issues?)
- All wealth involved in the criminal act
- All wealth involved in the criminal enterprise
- All wealth (and power) in the hands of criminals (subversives?)
- Those who have been unjustly enriched

  Article 20 UNCAC provides *"subject to its constitution…each State Party shall consider adopting such legislative and other measures as may be necessary to establish as a criminal offence, when committed intentionally, illicit enrichment, that is a significant increase in the assets of a public official that he or she cannot reasonably explain in relation to his or her lawful income."*
- Indirect and associated wealth (how far can you trace and how far is it reasonable (proportionate) to cast the net - for example article 52 UNCAC in regard to PEPs?
- Wealth that has become tainted by the method of its transmission – such as in violation of exchange controls or other fiscal constraints (relative issues)

- Wealth that has not been properly declared or taxed (relative issues)
- Wealth that has been stigmatized for some reason (usually political) – such as sanctions or indigenization (nationalisation).

How do we stigmatize property to render it accountable in our legal systems?

- The source of funds (proceeds of crime)
- The character of funds (tax evasion, contraband, prohibited commodities)
- The purpose for which funds are given, held or transferred (terrorism)
- Funds associated with crime such as those involved in facilitation or execution
- Those presumed to be objectionable (unaccounted for wealth in the hands of a public servant or possessed by those with a criminal life style).

There are many ways in which a criminal may be deprived of the benefits of his criminal activity and **it is important to look wider than specific proceeds of crime laws.**

For example, the benefits of criminal activity may be reduced by:

- Criminal, administrative and regulatory fines and financial penalties
- Disgorgement orders (absolute or conditional – possibly associated with Deferred Prosecution Agreements)
- Bankruptcy/insolvency proceedings
- Tax
- Legal and other costs
- Recognition and enforcement of orders (civil and criminal) from other jurisdictions
- Victim compensation orders (and regulatory third party proceedings).

And facilitating civil claims

- Liability to victims (Article 35 UNCAC)
- Unenforceability and rescission of contracts (Article 34 UNCAC)
- Liability for restitution (unjust enrichment – see Article 20 UNCAC)
- Liability to principals/employers etc
- Public civil claims – such as under the US False Claims Statute.

However, those with such claims must have the incentive to bring such claims.

There are possible disadvantages:

- Adverse publicity and reputation damage (possibly also to management)
- Exposure to other claims and complaints (particularly for those in control)
- Time, trouble and costs
- Is it worth it?

The importance of international mutual assistance

While emphasising the importance of substantive domestic proceeds of crime law allowing the freezing and confiscation of criminal property related to corruption and facilitating international mutual legal assistance in the recovery of assets – **the UN Convention against Corruption - has many provisions facilitating liability and recovery under the civil (i.e. non-criminal) law.**

In particular **Article 53**

Each State Party shall …

(a) take such measures as may be necessary to permit another State Party to initiate civil action in its courts to establish title or ownership of property acquired through the commission of an offence established in accordance with this Convention

(b) take such measures as may be necessary to permit it's courts to order those who have committed (such) offences to pay compensation or damages to another State Party…

(c) take such measures as may be necessary to permit it's courts or competent authorities, when having to decide on confiscation, to recognise another State Party's claim (as above)…"

The general Civil Law (common law)

Before the enactment of specific provisions for the tracing and recovery of misappropriated assets and the proceeds of fraud and corruption reliance was placed in England on the remedies available in the common law.

The civil law is primarily concerned with providing:

- Compensation for loss *(normally the law of tort)*
- Restitution of property on the basis of ownership and or unjust enrichment *(normally the law of trusts (equity)*

For there to be a remedy there must be:

- A recognised cause of action
- Standing to bring the action (usually but not always the 'victim')
- Jurisdiction.

Note the particular issues where companies are involved. A company is a separate legal entity and its affairs are in the hands of the board of directors. There are only limited circumstances where a minority of shareholders can bring an action derived from the company's right of action (ie a derivative action).

There are a number of other issues, but perhaps the most serious in utilising the civil law in taking the profit out of crime are:

- Obtaining evidence (investigation, discovery and securing of evidence)
- Finding a viable cause of action (in an appropriate jurisdiction)
- Involving a suitable and adequate tribunal (with jurisdiction)

- Identification of a viable litigant with *locus standi*
- Identification of a viable defendant (with accessible wealth)
- Ability of tracing and freezing orders
- Costs of initiating and sustaining the action
- Enforceability of judgments.

Factors that may be of relevance and assistance to initiating a viable civil action:

- Ability to access to previous and or continuing investigations (criminal and otherwise)
- Ability to access to official and third party assistance – regulators, liquidators, parallel claims, amicus curiae, 'bounty hunters' etc
- Availability (when relevant) of derivative/class and or representative actions
- Contingent fee arrangements
- Access to financial and other support (including technical – STAR Programme etc)
- Costs (in terms of security) for freezing and other interventions
- Adequate case management particularly where parallel proceedings.

Will we see increased use of professional 'bounty hunters' who acquire claims or who share in recovery?

And to what extent will governments and international organisations assist and participate in this?

ALSO is there a problem with using the private law (ie civil law) in relation to a public law wrong?

In considering the efficacy of the civil law within the common law tradition lets take the example of bribery.

In practice limited scope for actions in damages against either the

person receiving or paying the bribe.

Where the person receiving a bribe is in a fiduciary position (and this includes for examples government officials and members of the military) they will be accountable for **'secret profits'**

(Hastings) Ltd v. Gulliver (1967) 2 AC 134 Lord Russell of Killowen

"The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, ***in no way depends on fraud, or absence of bona fides*** *...or whether the plaintiff has in fact been damaged or benefited by his actions. The liability arises from the mere fact of a profit having ...been made.* ***The profiteer, however honest and well intentioned, cannot escape the risk of being called to account."***

In such cases the fiduciary is personally accountable for the unauthorised benefit that he has received (with interest).

Tracing

As this is a personal liability in English law the tracing remedy (allowing you to follow the illicit profit into other property) and impose a constructive trust on the resultant property was unavailable (**Lister v. Stubbs** (1890) Ch D 1).

The imposition of a **constructive trust** (predicated on a proprietary nexus) has a number of practical advantages over a mere personal liability to account, particularly in regard to third parties (insolvency) and where there has been an increase in the value of the property in question.

The case law has in some respects been confused as judges have been influenced by the presence or absence of dishonesty (even though dishonesty is not a constituent of liability) and the viability of a remedy (particularly where companies are involved).

This has been compounded by the under-developed state of the law in regard to certain aspects of property – such as maturing business opportunities which are diverted and the misuse of information (see for example, **Boardman v. Phipps** (1967) 2 AC 46).

Who is a fiduciary in English law?

Millett LJ in **Bristol and West Building Society v Mothew (1998)** Ch 1

> *"The distinguishing obligation of a fiduciary is the* ***obligation of loyalty****. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary. As Dr. Finn pointed out in his classic work Fiduciary Obligations (1977), p. 2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary."*

A robust approach by the Privy Council

(*contra* **Lister v Stubbs** (1890) Ch D 1) -

In **AG of Hong Kong v. Reid** (1994) 1 All ER 1 Lord Templeman stated "bribery is an evil practice which threatens the foundations of any civilised society …a fiduciary (in this case a prosecutor) acting dishonestly and criminally who accepts a bribe and thereby causes loss and damage to his principal must also be a constructive trustee and must not be allowed by any means to make a profit from his wrongdoing…"

Therefore the Privy Council held that a constructive trust may be imposed on the proceeds of a bribe and on derivative property.

Furthermore the law to be applied was where the money came to rest, or the property was found. So **it is not necessary for the country where the bribery took place to have a law of trusts - Sumitomo Bank Ltd v. Kartika Ratna Thahir** (1993) 1 SLR 735 (where the money was transferred to Singapore from Indonesia – a Roman Dutch jurisdiction!).

The door was therefore opened to the use of tracing and the imposition of constructive trusts in cases of bribery (and other cases of secret profits).

Of particular significance to jurisdictions such as the Republic of China.

The reach of equity

Furthermore, those who with knowledge and dishonesty (reckless indifference) participate in, or facilitate the **'laundering'** of the proceeds of a fraud of breach of fiduciary duty could be held personally liable (to make financial restitution) as if they were constructive trustees – **Agip(Africa) Ltd v. Jackson** (1992) 2 All ER 451.

The test is whether they have made the inquiries that an honest and reasonable man would have made.

Where there is a failure, wilfully and recklessly, to pursue inquiries which not only a honest and reasonable man would have made, but which in fact they had made there will also be liability (for receipt of trust property or dishonest assistance) - **Armstrong DLW Gmbh v. Winnington Networks Ltd** (2012) 3 All ER 425.

Where it is possible to trace the proceeds of a breach of fiduciary duty into the hands of a person, that person not being a *bone fide* purchaser for value without notice (of the misconduct – or fact that would suggest such – **Selangor United Rubber Estates Ltd v. Craddock (No 3)** (1968) 1 WLR 1555) then that person may take the

property (money) as a trustee (constructive or resulting) See **Nanus Asia Co Inc v. Standard Chartered Bank** (1990) 1 HKLR 396.

What are the duties of a putative constructive trustee or a person who might be considered to have given dishonest assistance in the breach of another's trust?

See in particular **Finers v. Miro** (1991) 1 WLR 35 – where you have a strong suspicion of fraud or misconduct in regard to property under your control (influence) then there is a responsibility to take reasonable steps to discover who may have a proper claim to it and inform them accordingly.

Serious implications for banks (and other intermediaries) who in the ordinary course of their business come into possession (control) of suspect funds – the horns of dilemma! **Governor and Company of the Bank of Scotland v. A Ltd** (2001) 3 All ER 58 and also problems of interface with the criminal law (especially the 'tipping off' offence).

The reaction of the Commercial Lawyers – concerned with protecting the rights of innocent third parties

HOWEVER, controversially Lord Neuberger MR sitting in the Court of Appeal in **Sinclair Investments (UK) Ltd v. Versailles Trade and Finance Ltd** (2011) 3 WLR 1153 considered that this robust (ends justifies the means approach!) was wrong in law and that **Lister v. Stubbs** was correct after all in English Law!

The Court of Appeal was particularly concerned about the plight of innocent creditors if a constructive trust was found to exist over assets in an insolvency. The Court also thought it was bound to follow precedent over an opinion of the Privy Council!

This had serious implications for asset recovery!

This interpretation of the law significantly reduced the circumstances where the tracing remedy is available and in which the courts can impose liability as a constructive trustee (**in English Law**).

Following the **Sinclair** decision there had to be a misuse (diversion or misappropriation) of property – **BUT what is property in this context?**

This uncertainty in the law (and its application) has been compounded by the under-developed state of the law in regard to certain aspects of property – such as **maturing business opportunities** which are diverted and the **misuse of information** (see for example, **Boardman v. Phipps** (1967) 2 AC 46.

However, many consider these arguments were over theoretical and according to **Sinclair** in cases of bribery or the taking of a mere secret profit where the person taking the bribe or receiving the profit is in a relationship with the principal akin simply to that of a debtor **there being no proprietary nexus – the courts will not be able to impose a constructive trust.**

However – within months:

FHR European Ventures LLP v. Cedar Capital Partners LLC (2014) UKSC 45, Lord Neuberger now as President of the Supreme Court has taken the law back (more or less) to the **Reid decision.**

The potential for 'bounty hunting'

- Assignment (or purchase) of claims
- Creation of new causes of action
- No win no fee arrangements
- Role of insurers
- External assistance (governmental or elsewhere)
- Parallel with other enforcement (criminal and or regulatory)
- Empowers jurisdictions that cannot (for whatever reason) take full advantage of international legal co-operation and mutual legal assistance.

The failure of the traditional criminal law: should we think a new?

Are we any good to interdicting criminal property - with the tools that we have and within the rule of law?

The ordinary criminal law in most systems is reasonably effective in taking control over:

- The instruments of crime
- The immediate proceeds (in possession) of crime

It is less effective once there has been an opportunity for laundering:

- In the first decade of proceeds of crime law in the UK the authorities were able to confiscate £ 37.2 million of drugs related criminal property and £ 4.5 million of criminal property for all non-drugs related crime. The UK National Audit Office (NAO) in its report on confiscation (December 2013) estimated that the UK authorities confiscated less than 26 pence in every £ 100 of criminal property.
- The civil asset recovery regime was and is still criticised in the UK for not meeting expectations (although *in rem* proceedings in the USA are relatively successful)
- While today seizures (freezing) is significant, actual confiscations remain less than many would like.

"An estimated US $ 20 to US $ 40 billion (*Oxfam puts it at US $ 90 billion*) is lost to developing countries each year through corruption …The Stolen Asset Recovery Initiative (STAR) estimates that only US $ 5 billion of stolen assets has been repatriated over the past 15 years…" **Barriers to Asset Recovery** 2011, World Bank.

Asset recovery in regard 'criminal property' in Europe has been described as *'pathetic' 'ineffectual' 'scraping the top of an iceberg' 'lacking credibility' 'deficient in any cost benefit analysis' 'yet to be*

proven' and amounting to less than 0.0001 per cent of what could be confiscated!

And what are the costs of the criminal law approach?

Have we consciously turned our bankers, intermediaries and their professional advisers into the front line against organised crime and terrorists?

Or is this the price that responsible and remunerated citizens should pay for the privilege of minding other people's wealth?

Are they as the US Securities and Exchange Commission said of reporting accountants in 1963 our **'reluctant policemen?'**

It is argued that the (unintended?) consequence of placing those who mind other people's wealth in the front line in obtaining information which can be processed into intelligence is to re-locate legal (regulatory and reputational) risk.

Have we given adequate thought to this?

Recent cases (particularly in the USA and UK) imposing regulatory and criminal penalties on financial institutions for failing to have (with the benefit of hindsight) sufficiently adequate reporting and recording procedures have severely damaged their standing and arguably **the reputation of certain international financial centres.**

Many of these cases have not involved the proceeds of crime as such but the efficacy of economic sanctions

Is it appropriate (or sensible) to regard the leading financial institutions, in this context, as money launders and worse?

Have we not confused what we are seeking to achieve?

Given the direct and indirect costs (and risks) created by the anti-money laundering regime in many countries some have questioned whether the **intelligence** that is (or could) be developed is cost effective?

It is also questioned whether the information in most jurisdictions

can be developed into useable intelligence given the constraints of resources and law? A real issue for developing countries – is it all worth it (for them)?

Is there adequate **sharing of intelligence** (particularly relating to strategic issues and revenue related activity)? And who has access to it?

Financial intelligence (such as that developed in regard to PEPs) might well have political implications far beyond the traditional criminal justice system.

Furthermore, the mechanisms and procedures involved in 'reinforcing' AML do not work as well in every jurisdiction – **one size does not fit all!**

There is little opportunity in any legal system to test the cost benefit!

The more so, because in many jurisdictions the emphasis in fighting crime has moved from the traditional (and constitutional) approach of investigation to prosecution in the reasonable expectation of conviction, to **intervention** or rather **disruption** of criminal activity.

This impacts on issues of transparency, accountability and proportionality and the rule of law!

It is also arguable that the proceeds of crime laws and anti-money laundering laws are not ideally suited for dealing with **terrorist related funds** (and especially those who have been re-habilitated!).

The US PATRIOT Act had been designed in large measure to address organised crime which is more likely to operate as a 'continuing criminal enterprise' than for example a terrorist organisation that depends to a greater or lesser extent on 'clean money' coming in through donations (culpable or otherwise.

Final Report of the National Commission on Terrorist Attacks upon the US (2004)

Chapter 12 – *"The general public sees attacks on terrorist finance*

*as a way to 'starve the terrorists of money.' So, initially, did the US government …These actions (i.e. legal measures) appeared to have little effect …These early missteps made other countries unwilling to freeze assets …merely on the basis of a US action…**trying to starve the terrorists of money is like trying to catch one kind of fish be draining the ocean"**.*

On the other hand not with standing the relatively small (usually very small) amounts of money seized (anywhere) that can be proved to be related to terrorism, it is assumed that financial intelligence plays a role in intervention and particularly in investigation.

"What we need is to empower those with the will, resources and humanity to go after those who directly or indirectly harm us all. Such persons, even if their motives are not pure – but are rather more associated with rewards and the taking of professional fees, do us all a service. What is fundamental is that those who abuse their positions and place their own and their family's interests above those of society- cannot in any circumstances be allowed to retain the fruits of their misconduct!" President Obama (2013).

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