A POWERFUL FREEZE FROM CANADA: *MAREVA* INJUNCTIONS STOP FRAUDSTERS COLD

Canadian courts provide various powerful remedies to protect the victims of fraud, including *Mareva* injunctions — an extraordinary remedy that freezes the assets of alleged fraudsters or property traced to a fraud

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The powerful *Mareva* injunction is one of the most devastating weapons in the Canadian commercial litigator's arsenal. The order prevents a party (usually an apparent fraudster) from removing, spending or dissipating funds in the course of litigation that would otherwise deprive the claimant from the benefits of judgment. US counsel overseeing potential Canadian or cross-border litigation are well-advised to consider this remedy before their client becomes immersed in urgent litigation involving fraud or other dishonest conduct, by which time assets may have already been sequestered away. Alternatively, if your client is the subject of a freezing order, or is a third-party recipient of an order, it is crucial to react swiftly and prudently in order to ensure compliance.

As its description implies, the order freezes some or all of a party's assets, usually, and remarkably, well before trial. A freezing order may also require the defendant to provide an affidavit, detailing information about his or her assets. Non-compliance with the order, either in terms of the movement of assets, or the non-disclosure of assets, will haunt the credibility of the defendant throughout the litigation and may result in contempt proceedings. A successful and properly obtained freezing order at the commencement of legal proceedings reverberates throughout those proceedings beyond the freezing of the assets themselves.

Since their inception in England in 1975, freezing orders have become an established fixture on the English and Canadian commercial litigation landscape (*Mareva Compania Naviera S.A. v. International Bulkcarriers S.A.*, [1975] 2 Lloyd's Rep. 509 (Eng. C.A.) and *Aetna Financial Services Ltd. v. Feigelman*, [1985] 1 S.C.R. 2). Although courts once limited their reach to assets within their own geographic jurisdictions, Canadian and English courts now recognize their authority to freeze a defendant's worldwide assets.

Although a party should not seek a freezing order

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on purely strategic grounds, freezing a party's assets has a persuasive effect on early settlement. A freezing order, secured at the outset of litigation, offers the possibility of a swift, effective and relatively inexpensive resolution, coupled with real recovery for the victims.

A Rigorous Test

In most Canadian jurisdictions, the traditional test requires that the applicant show a strong *prima facie* or good arguable case, and a real risk that the defendant will remove or dissipate assets to avoid judgment, and if not, the order will not be granted.

Some Canadian jurisdictions, such as British Columbia, where the authors practice, take a more broad and flexible approach to freezing orders. Although generally courts will not issue freezing orders unless fraud or other intentional nefarious conduct can be shown, British Columbia courts have consistently stated that "they are not prisoners to a formula" (to quote a recurring theme in the jurisprudence) and that a freezing order may be granted wherever justice demands it. That being said, British Columbia courts, like other Canadian jurisdictions, agree that a freezing order should not be granted based merely on "speculation that the plaintiff will ultimately succeed in its claim and have difficulty collecting on its judgment if the injunction is not granted," to quote the recent authority of *ICBC v. Patko*, 2008 BCCA 65.

Worldwide Freezing Orders

As Canadian courts have developed expertise and confidence in issuing freezing orders, they have extended the reach of such orders beyond the domestic jurisdiction: courts may and do grant worldwide freezing orders. Such orders effectively freeze the assets of the defendant wherever situated. This extra-territorial reach arises when the Canadian court has *in personam* jurisdiction over the defendant: more clearly in scenarios where a freezing order is granted after the defendant has attorned to the domestic jurisdiction, or any other person with a physical or business presence in the issuing jurisdiction. If the defendant or a third-party recipient of the freezing order ignores or breaches the order, that party can be punished through domestic contempt proceedings.

In order not to offend international principles of comity, the standard worldwide freezing order expressly permits a foreign third-party recipient, such as a bank, to comply with whatever it reasonably believes to be its contractual or other obligations under the laws of its own domestic jurisdiction.

Flexible and Practical Procedure

In most circumstances, the applicant will prepare and file materials starting legal proceedings, along with affidavit material setting out the cause of action, and evidence that the assets in question may well be dissipated before trial. In more urgent cases, the matter may be heard on the basis of *viva voce* evidence.

To prevent the defendant from swiftly removing or dispensing his or her assets, these materials are filed, but generally not served upon the defendant until after the order is obtained. In most cases, the matter is then first heard *ex parte,* without notice to the parties. Canadian court registries are usually accommodating in allowing the motion to be heard immediately or within hours of filing.

The order is almost always limited in time, with leave granted in advance for the defendant to return to apply for the release or variance of the order on notice. A claimant successfully obtaining an injunction must expect a furious return to court, to face a battery of evidence, and responsive arguments microscopically dissecting the fullness and frankness of the claimant's earlier *ex parte* submissions.

As often happens, however, the freezing order is the beginning of the end for the defendant: negotiation and settlement avoids the return to court.

An injunction may be granted at any time during the litigation, and even after judgment has been given. That being said, if litigation has been ongoing, and the defendant has attorned to and complied with the court's processes, it is more difficult to establish the need for a freezing order.

Historically, typical freezing orders froze the entirety of the defendant's assets. Now, courts insist upon more nuanced terms. The defendant is generally allowed to move assets in the ordinary course of its business. The defendant is also permitted reasonable living and legal expenses. Finally, the freezing order should not freeze assets in excess of the amount claimed in the litigation.

The order will often place a cap on withdrawals permitted by the defendant in a given period. Another method is to make a provision for a financial institution holding the defendant's assets to

create a separate account with a limited amount that the defendant may access.

For practical enforcement, the order is served on the financial institutions and other parties who are known to, or are likely to, hold assets of the defendant. Ideally, these institutions, with specific account numbers, will be listed in the order, but the typical order contains a blanket prohibition against dealing with assets, to which even financial institutions that are not specifically listed must comply. The freezing order should also, where possible, be registered on title of all real estate owned by the defendant.

High Rewards, but High Risks

Applying for a freezing injunction is a high-stakes exercise for several reasons. First, the application is almost always made *ex parte*, to prevent the fraudster defendant from sequestering away his or her assets before the freezing order is granted. As such, applicant's counsel is required to make full and frank disclosure of all material facts to the court. As there is often very little time to prepare the materials for a freezing order, and as such information is often murky at best in a fraud scenario, it is often a challenge to uncover and disclose sufficient facts to ensure that you are meeting your client's duties of disclosure. Counsel must bring to the court's attention not only the facts that might fairly assist the defendant's case, but also the applicable law. Even innocent non-disclosure can result in the setting aside of the order, and a marked failure in disclosure may well attract judicial castigation, as well as a full-indemnification costs award payable to the defendant.

Second, as with most injunctions, the applicant must provide an undertaking to the court to compensate the defendant for any damages if it is later determined that the order should not have been granted. And when a party's assets are substantially frozen, there is significant risk of significant damages, for which the applicant could be liable.

Finally, a freezing order that is improperly or sloppily obtained, or an order that is drafted too broadly or imprecisely, will cost the party, and counsel personally, heavily in terms of credibility with the court. Canadian jurisprudence contains many judicial chastisements against parties seeking freezing orders for an ulterior purpose of litigation blackmail. An improperly obtained freezing order that is later set aside can hobble the claimant from the outset of litigation, rather than empower it.

What if Your Client is Served with a Canadian Freezing Order?

The defendant whose assets form the subject of the freezing order tends to be a rogue. Indeed, fraudulent conduct on the part of the defendant is usually the main factor in a court granting the order. It is frequently futile and naïve to expect such defendants to respect the order and restrain themselves from moving or dissipating their assets. A claimant obtaining a freezing order thus enforces it primarily by serving it on persons and institutions that hold funds for the enjoined party: most commonly banks, credit unions and other financial institutions. What was once a rare and extreme legal remedy is now a daily occurrence in Canadian courts, and financial institutions, including US financial institutions, should be prepared to receive and respond to such orders at any time.

Even innocent non-disclosure can result in the setting aside of the order, and a marked failure in disclosure may well attract judicial castigation, as well as a full-indemnification costs award payable to the defendant.

A financial institution is often stuck between a rock and a hard place when served with a Canadian freezing order. On one hand, it has duties to the defendant client and may wish to preserve that business relation-

ship. On the other hand, the recipient of a Canadian freezing order faces serious sanctions if it does not correctly comply with the order, even one issued from outside the recipient's jurisdiction. If the recipient has a physical or business presence in the jurisdiction of the issuing Canadian court, it could well face contempt proceedings.

However, there is some good news for financial institutions caught in the middle of such issues. Initially, the English Court of Appeal found that a bank that did not take adequate care to freeze funds pursuant to an order could be liable to the claimant in negligence if the client-defendant absconded with the funds that ought to have been frozen. Happily for financial institutions, Britain's highest court later reversed that decision: *Her Majesty's Commissioners of Customs and Excise v. Barclays Bank plc*, [2006] UKHL 28, held that a bank will not be liable if it innocently fails to freeze funds.

The news is not all rosy, however: *Barclays* also confirms that banks and their employees may face contempt of court charges where the freezing order is not properly followed.

Freezing orders are often complicated and lengthy, and their scope and requirements are not always clear. Given the international scope of modern finance, and the possible sanctions for failure to comply, US-based financial institutions and other recipients of freezing orders would be wise to seek advice as to whether, how and to what extent they must comply with this seemingly draconian order issued by a foreign jurisdiction.

Other Powerful Canadian Litigation Tools

Freezing Evidence

Preserving assets against the ravages of a fraudster is crucial in litigation, but such temporary seizure will be worthless if the fraudster destroys the evidence necessary to prove entitlement to those funds. But Canadian law provides a remedy.

Another extreme litigation remedy often obtained in conjunction with the freezing order is the *Anton Piller* order (from the case of that name: [1976] 1 Ch. 55). Called both a "civil search warrant" and a "neutron bomb of remedies," the *Anton Piller* order permits the applicant to attend at the defendant's premises and seize documents and materials so as to prevent the defendant from destroying evidence. Increasingly, the injunction is used to seize computer hard drives. Although documents – both paper and electronic – are the most frequent targets of *Anton Piller* orders, the orders are often used to seize goods, particularly in actions to counteract piracy, counterfeiting and other intellectual property torts.

The order is civil, not criminal: the defendant is not obliged to allow the search to proceed, and may refuse entry. But if he does so, he immediately harms his credibility before the court in the litigation, and also faces contempt proceedings, with possible criminal sanctions, for breach of the order.

As with the freezing order, an *Anton Piller* order is usually obtained *ex parte*. The defendant usually first hears of the order after he hears a knock on his door and is presented with the order. The order is generally carried out by a representative of the applicant, the party's lawyer, and an independent supervising solicitor specially retained for the purpose of the execution of the order. While police frequently attend the execution of such orders, recent case law indicates that they should only do so to keep the peace, and not to facilitate the execution of the order.

As with the freezing order, the test for an *Anton Piller* order is strict. The applicant must set out an extremely strong *prima facie* case, along with clear evidence that the defendants have possession of material documents or evidence, that there is a real possibility of destruction of such crucial evidence before an ordinary disclosure order may be made, and that if the materials were destroyed, the harm to the claimant would be serious.

As with the freezing order, obtaining an *Anton Piller* order is fraught with risk: not only may the order be set aside and counsel and the party chastised for failure to make full and frank disclosure, but if the party carrying out the *Anton Piller* order is exposed to privileged materials (an increasingly frequent risk given the seizure of hard drives and electronic materials), counsel may be removed from the file.

Broad Non-party Discovery

Finally, what if the perpetrators of a fraud or another tort, such as Internet defamation, are unknown? Again, Canadian law provides a solution. A third Anglo-Canadian remedy often obtained in fraud scenarios is commonly known as the *Norwich Pharmacal* order (from *Norwich Pharmacal Co. v. Commissioners of Customs and Excise*, [1973] 2 All E.R. 943 (H.L.)), otherwise known as the equitable bill of discovery. The *Norwich Pharmacal* order allows a party to obtain information from a non-party, such as an

Internet or telephone service provider, a payment processor, a government agency or a financial institution. Where the perpetrators of the fraud or other tort are unknown, the claimant may commence a *Norwich Pharmacal* order against that third-party holder of information solely for the purpose of obtaining that information.

As the order only provides discovery, it is much more readily granted than the freezing and *Anton Piller* orders. The applicant must show the court that it is not merely on a fishing expedition, that it has made reasonable efforts to obtain the information from other sources and that it has a reasonably strong claim. It must also show that the defendant somehow was involved in the fraud or wrong action in question, even if unwittingly, and that it is the only practicable source of the information. Finally, the applicant must convince the court that the order ought to be granted in the overall interests of justice.

Many proprietors with confidential information would be willing to provide that information, but are required by privacy laws, customer relations or otherwise, to insist upon a court order before releasing that information. Note that in most Canadian jurisdictions it is possible, where the true defendant is unknown, to commence an action in the name of John or Jane Doe, and then use non-party discovery rules to compel effectively the same disclosure; in these jurisdictions, such as British Columbia, the *Norwich Pharmacal* remedy is less necessary.

Conclusion

Given its power, but also given the significant potential pitfalls of the freezing order, the procedure should not be undertaken lightly. However, if well executed, the freezing order could literally save millions of dollars, represented both by the litigation fees spent chasing a dry judgment, and the disputed funds themselves, sequestered safely away from the claimant by the wrongdoer long before judgment day.

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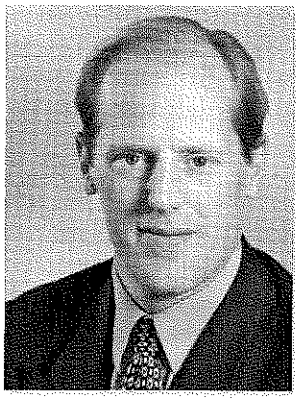

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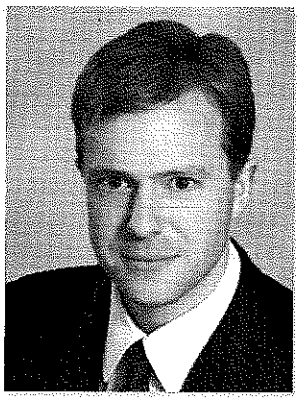

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