FORTIFICATION FOR DAMAGES IN FREEZING INJUNCTIONS: OUT WITH THE OLD, IN WITH THE NEW?

Authored by: Sian Mirchandani QC - 4 New Square

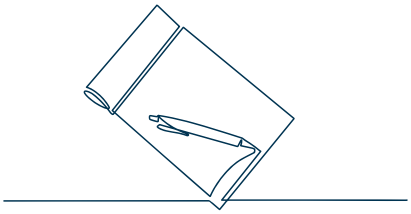
What is fortification?

Freezing injunctions or 'freezing orders' are commonplace in the Commercial Court of England and Wales, particularly when there has been conduct which is either potentially fraudulent or indicates the defendants may be putting their assets out of reach of creditors. Once in place freezing orders mean assets (including the contents of bank accounts) are protected pending the outcome of ensuing litigation – they are an effective mechanism to ensure there is a 'money pot' worth fighting over.

The Commercial Court's wide powers to grant such interim remedies is one of the reasons commercial parties elect in international agreements to have jurisdiction clauses that ensure disputes are heard exclusively before the courts of England and Wales. There are various stages which the courts must go through before this interim remedy is granted. For an applicant to obtain a freezing order, they will have to meet the requirement for providing a cross-undertaking in damages to the court (not the respondent). This is a form of protection for the respondent whose ability to function and trade may be severely affected by the asset freezing only for the ensuing litigation against it to fail.

The need to provide an undertaking in damages as a pre-condition to obtaining a freezing order sometimes causes problems for the applicant in showing that they have sufficient assets within the jurisdiction to give validity to the undertakings being offered (akin to provision of security – though this is a distinct procedure from the mechanism under CPR 25.12). It is at this point that fortification comes into play. The respondent to an application for a freezing order can make a counter application for fortification of the undertaking in damages proffered by the applicant. The court will then try and ascertain what harm a respondent may suffer, and how that harm might be offset by fortification. The fortification itself may be achieved by way of a parent company guarantee, a payment into court or to the applicant's solicitors (to be held by them as officers of the court pending further order), by means of a bond issued by an insurance company or a first demand guarantee or standby credit issued by a first-class bank (See Fortification of Undertakings: F15.4 of the Admiralty and Commercial Courts Guide).

Since these applications arise in the early stages of the proceedings, the amount of fortification initially ordered by the court may be far less than the loss a respondent anticipates suffering. In such circumstances a further application for fortification can be made by the respondent to protect itself.



What are the principles the court will apply when considering an application for fortification?

It is a matter of discretion for the court as to whether fortification of a party's undertaking in damages is appropriate. The starting point is that the party seeking fortification must show a good arguable case that it will suffer loss as a result of the injunction and must also demonstrate an evidential basis for the application.

The principles for the court to consider have been laid out by Popplewell J. in *Phoenix Group Foundation v Cochrane* [2018] EWHC 2179 (Comm) at [14]:

(1) Can the applicant show a sufficient level of risk of loss to require (further) fortification, which involves showing a good arguable case to that effect?

(2) Can the applicant show (to the standard of a good arguable case) that the loss has been or is likely to be caused by the granting of the injunction?

(3) Is there sufficient evidence to allow an intelligent estimate of the quantum of the losses to be made?

In order to justify fortification one must also establish causation of the loss, i.e. that the loss for which fortification is sought, is caused by the applicant's freezing injunction. That requires a respondent to disentangle losses which arise (or are likely to arise) from the litigation from the losses caused by the restraint to business activities caused by the freezing injunction itself. If this has not been shown, then fortification cannot be ordered (*Financiera Avenida v Shiblaq* [1994] 1 Lloyd's Rep 577).

The requirement for an evidential basis has been expressed in a number of authorities [1] – there must be real evidence capable of objectively establishing the risk of loss which is being asserted in the fortification application.

Recent Developments

Until recently, the law was fairly settled on whether fortification could be ordered: after it had been shown there was a good arguable case that a sufficient risk of loss to the respondent arose by reason of the freezing injunction, then some "real evidence" as to the potential loss would need to be shown before an application for fortification would be granted.

However, the recent High Court decision in *Claimants Listed in Schedule 1 v Spence [2021] EWHC 925 (Comm)* has cast some doubt upon this apparent consensus. The claimants had obtained a worldwide freezing order against two defendants: Mr Spence and Mr Kewley – and provided fortification of £500,000 via an insurance policy. The defendants applied to vary the level of fortification because one of them (Mr Spence) asserted that he faced a "very substantial risk" of suffering a loss of at least £2 million.

The risk of loss was claimed to arise because Mr Spence had borrowed circa $9.3 million from Coutts, (the dollar loan) which was secured against his sterling deposits in excess of £8 million also held with Coutts. This arrangement was put in place because Spence had moved to the United States of America when the exchange rate of pounds sterling against the US dollar was at a historic low. The benefit of the dollar loan arrangement was that it allowed Spence to spend US dollars without having to exchange his pounds sterling at a rate that he considered unfavourable.

As applicant to vary the level of fortification it was Spence's assertion that he intended to exchange his sterling deposits for dollars when the exchange rate reached £1: $1.55. In his application Spence asserted that due to the worldwide freezing order being granted, there was a substantial risk that Coutts would call in the dollar loan or enforce its security. That would lead to his having to accept whatever exchange rate pertained at the time Coutts made such a decision, which, Spence asserted, was likely to be less than £1:$1.55. Spence sought fortification for a resulting potential loss of, at least, £2m based on the lowest exchange rate that had arisen during the period of the loan.

Moulder J granted additional fortification of £800,000.00, (additional to the existing fortification of £500,000). So how did the applicants for fortification show on an objective basis that there was a "good arguable case of a risk of loss" and that this was caused by the injunction?

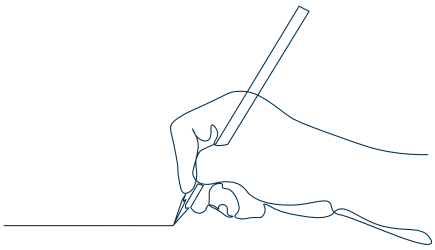
Three problems arise with this decision:

(1) Coutts, despite being aware of the freezing order, had not suggested that it would terminate the loan. The "Events of Default" clauses in the loan agreement had not been triggered by the freezing order having been made, and Coutts were in a comfortable position being fully secured and receiving interest on the loan, the payment of which was not prevented by the freezing order. In short, there was no evidence that the risk of recall on the loan was present, or that it was caused by the freezing order.

(2) No real or documentary evidence was adduced to support Mr Spence's assertion that his intention was to keep the dollar loan arrangement until the exchange rates recovered to a level of £1:$1.55. His proposed plan also lacked any commercial reasoning – as he was paying interest on the loan whilst waiting for the currency exchange rate to improve in his favour, he could not sensibly hold his position indefinitely. At some point the payment of interest to Coutts could make the dollar loan arrangement, as he described it, uncommercial.

(3) The estimate of loss was not an informed, intelligent or realistic estimate. Not only had Mr Spence's assertions of loss fluctuated from £800,000 to £2.6million, his calculations of loss failed to account for his ongoing liability to pay interest on the dollar loan facility.

1 JSC Mezhdunarodniy Bank v Pugachev [2015] EWCA Civ 139; Brainbox Digital Ltd v Backboard Media GMBH [2017] EWHC 2465 (QB); Phoenix Group Foundation v Cochrane [2018] EWHC 2179 (Comm); Create Financial Management LLP v Lee [2020] EWHC 1933 (QB).



Discussion

The existing authorities plainly highlight the need for real evidence to support an application for fortification, and further that the evidence should be capable of objectively establishing the risk. But in this case, there was a resounding lack of real evidence to establish such a risk actually arose, or that it was caused by the freezing injunction.

The judge in this case actually noted that there was an "*absence of any evidence to support*" Mr Spence's assertion that he intended to convert his dollars into sterling only when the exchange rate reached £1:$1.55. Having noted the absence of this evidence, the judge nevertheless elected to take Mr Spence's assertion at face value. It is difficult to see how, even accepting Mr Spence's assertion as to his intention, that there was a sufficient evidential foundation (when viewed objectively) that the claimed loss had been or would be suffered. There also appears to be no adequate basis for the conclusion that the risk of loss was caused by the freezing injunction. The decision in *Spence* has been appealed and the outcome is awaited.

In *PJSC National Bank Trust v Mints [2021] EWHC 1089 (Comm)*, a case decided shortly after the above case, Calver J stated that when one is considering an application for fortification: *"there does indeed have to be a solid, credible evidential foundation that the claimed loss has been or will be suffered"*.

Where are we now?

The contrasting decisions of Moulder J. and Calver J. handed down just two weeks apart has created uncertainty in an area of law that was previously notably consistent in approach. The admittedly low threshold for an application for fortification of showing a 'good arguable case' for the existence of a risk of loss was subject to a balancing, comparatively stringent requirement for an objective and credible evidential basis for the application, a supportable estimate of loss, and also required that the loss was shown (to the standard of a good arguable case) to have been due to the freezing order not the litigation itself.

It will be interesting to see whether the status quo will be restored by the Court of Appeal, or whether a new test will be applied in this area. If the decision in Spence is upheld on appeal, a possible effect will be that respondents will pursue fortification despite lacking a credible evidential basis that the claimed loss will be suffered. If applicants for freezing orders know they will face losing such evidentially weak fortification applications this may discourage them from pursuing freezing orders. It could stifle or severely reduce the use of this powerful and necessary interim remedy.