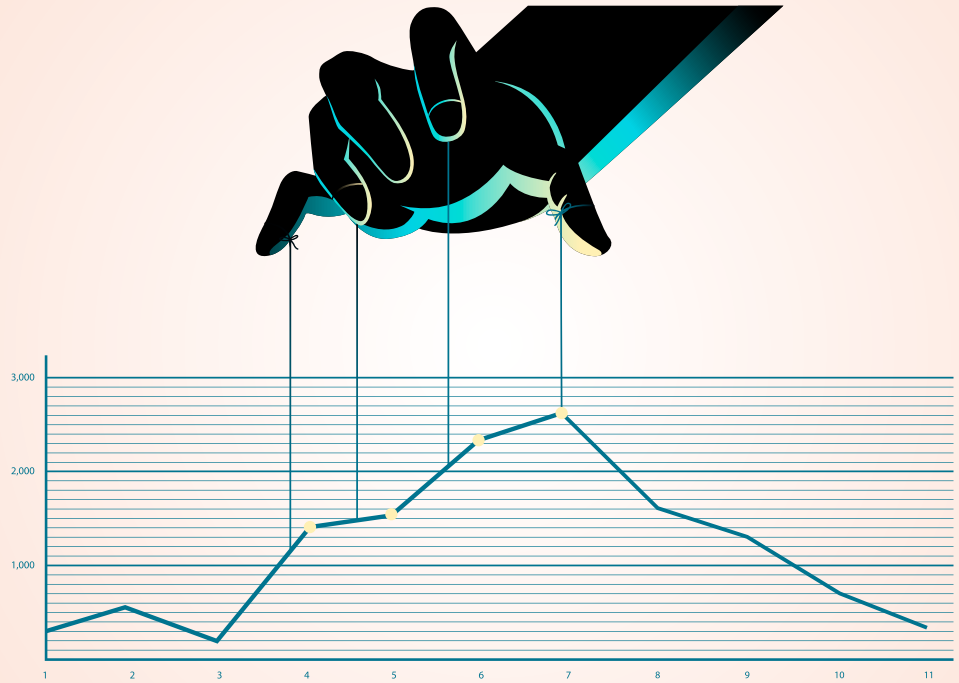
FORTIFICATION FOR DAMAGES



A "GOOD ARGUABLE CASE OF A RISK OF LOSS" OR MERE SPECULATION?

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In the decision earlier this year in Claimants Listed in Schedule 1 v Spence[1], the Court of Appeal has restored the status quo and clarified the law on fortification of damages in freezing injunctions.

Background

Mr Spence was the subject of a worldwide freezing order ("WFO") for which £500,000 had been provided by way of fortification. Mr Spence applied to increase the level of fortification. He had borrowed $9.3m from Coutts which was secured against his Coutts Sterling deposits of £8m. He was paying considerable interest for this arrangement: £120,000 per annum. Mr Spence had moved to the US when the exchange rate was not in his favour. In his application, he asserted that he intended to exchange his Sterling deposit once the exchange rate reached £1:$1.55. He argued that following the granting of the WFO, there was a substantial risk that Coutts would call in the Dollar loans or enforce its security leaving Mr Spence subject to whatever exchange rate existed at the time and that this could result in a potential loss of at least £2m based on the lowest exchange rate that had arisen during the period of the loans.

At first instance, Moulder J had granted the application and had ordered that further security of £800,000 (which she considered to be the likely amount of the loss) be provided despite i) the absence of any suggestion by Coutts that it would terminate the loans[2]; ii) no real or documentary evidence was adduced to support Mr Spence's assertion that he would keep the Dollar loans arrangement until the exchange rates reached a level of £1:$1.55; and iii) the estimate of loss was not informed, intelligent or realistic[3].

The principles to consider

The principles as to fortification are set out in Energy Venture Partners Ltd v Malabu Oil and Gas Ltd[4] and in Phoenix Group Foundation v Cochrane[5]:

1. Can the applicant show that there is a sufficient level of risk of loss to require fortification which involves showing that it has a good arguable case that it will suffer loss?
2. Is there sufficient evidence to allow an intelligent estimate of the quantum of the losses to be made? An intelligent estimate will be informed and realistic although it may not be entirely scientific.[6]
3. 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 as opposed to the underlying proceedings.[7]

1 [2022] EWCA Civ 500
2 Lord Justice Phillips found at [47] that there was insufficient evidence to justify the finding that there was a real (as opposed to fanciful) risk that Coutts would call in the loans.
3 Lord Justice Phillips at [50] described Moulder J's findings as to potential loss as "intelligent guesswork rather than intelligent estimation".
4 [2014] EWCA Civ 1295, [2015] 1 WLR 2309
5 [2018] EWHC 2179 (Comm) at [14]
6 Lord Justice Phillips at [20] did not consider this to be a separate requirement, but rather "an obvious aspect of the need for the applicant to demonstrate a good arguable case".
7 Likewise, Lord Justice Phillips at [21] regarded this as an important principle for the Court to bear in mind, but to be "no more than an aspect of the causation element".

Judgment

Lord Justice Phillips considered Moulder J's approach to be too narrow and that it had failed to take into account the nature and effect of Mr Spence's overall financial arrangements and planning. He considered that Mr Spence's arrangement with Coutts was to ensure that Sterling-Dollar exchange rate movements did not cause Mr Spence any net loss. If Sterling appreciated, the increased rate of the Sterling Deposit would match the diminution in value of his US assets, and vice versa. What Mr Spence would potentially lose would be the hedge that he had in place against the depreciation of the Dollar. He likened this to an insurance policy which can be easily reconstituted or replaced before the risk eventuates. In such circumstances, the loss suffered must be limited to the cost of putting in place an alternative arrangement (in this case, a replacement hedge or forward currency trades and/or one or more derivative products) and not the prospective loss which would be suffered if the risk materialises without protection in place.

Ahead of the hearing, the Court had asked Mr Spence to submit evidence as to the availability and cost of alternative arrangements, but he did not consider it reasonable to do so given the potential complexity of the transactions. Lord Justice Phillips disagreed and considered that it was reasonable to obtain this. Indeed, he said that adducing evidence that such replacement options were not reasonably available was a pre-requisite of inviting the Judge to embark on the assessment of highly speculative future losses. Overall, he found that Mr Spence had failed to adduce evidence demonstrating a good arguable case that he would suffer loss.

Mr Spence's claim was for entirely speculative losses in what was in any event an unlikely scenario and one which he could have easily protected himself.

Comment

Calver J also gave support to the requirement for "solid, credible [evidence]..that the claimed loss has been or will be suffered" in PJSC National Bank Trust v Mints [2021] EWHC 1089 (Comm).

These decisions will be of relief to claimant practitioners in making civil fraud claims more affordable for claimants.

If such evidently weak fortification applications were to be allowed, they could render the powerful interim remedy of a freezing order somewhat toothless.

The more speculative the loss, the more evidence will be needed to persuade the Court irrespective of how complex the financial transactions are. The Courts are expecting more of an open book approach with considerable detail as to losses and explanations as to how such losses might be mitigated. Typically respondents are evasive as to the extensive level of detail required in response to civil fraud claims and injunctions and have been prone to a bit of exaggeration (or complete speculation as in this case) when it comes to the losses they claim they will suffer as a result of a freezing order so this decision will be a welcome back to reality check for claimants.