MACFARLANES

SLIPPING ANCHOR – US CLAIMANT'S SUIT AGAINST EUROPEAN DEFENDANTS SET ASIDE

THE LONDON LITIGATION LETTER

In this eBulletin we look at the recent case of *Madoff Securities International Ltd v Raven and others [2011] EWHC 3102* in which the English Commercial Court ruled that it did not have jurisdiction to hear a claim by the liquidators of the UK entity against European based defendants (not domiciled in England).

INTRODUCTION

Through his New York based company, Bernard L Madoff Investment Securities LLC (BLMIS) Bernard Madoff perpetuated a massive multi-billion dollar fraud on investors by way of a Ponzi scheme. In 1983 he established Madoff Securities International Limited (MSIL), a UK incorporated entity. MSIL was 99 per cent owned by Bernard Madoff (his brother Peter held the remaining 1 per cent). The ostensible purpose of MSIL, it was alleged, was to hold a seat on the London International Financial Futures Exchange. However, its primary function was to facilitate the concealment of Mr Madoff's fraud and the distribution of its proceeds. In particular Mr Madoff used MSIL to launder stolen money and as a vehicle for making payments of stolen money.

In the 1980s Mr Madoff met Mrs Kohn, an Austrian national who lived and conducted her affairs internationally through a series of corporate vehicles. Mrs Kohn subsequently began to introduce investors to Mr Madoff; the money they invested with him amounted to billions of dollars. Over the years Mrs Kohn and her corporate vehicles received tens of millions of dollars directly from BLMIS and indirectly via MSIL. Mrs Kohn claimed that the payments were for research, analysis, and consulting.

THE OVERARCHING CLAIMS

MSIL issued proceedings against (i) the directors of MSIL (including Peter Madoff and his two sons); and (ii) Mrs Kohn and her corporate vehicles (together, the "Kohn Defendants"). The majority of the MSIL directors were domiciled in the UK; however, Peter and his two sons were not. MSIL claimed that:

1. in making the payments to the Kohn Defendants, the directors of MSIL breached their respective contractual and fiduciary duties owed to MSIL because each knew the payments were inappropriate and suspicious and/or had knowledge of numerous indicia that they were illegitimate payments; and

2. Mrs Kohn knew the payments were really secret payments or "kickbacks" for introducing money into Madoff's scheme and that the various invoices were in fact sham documents intended to hide the true nature of payments made to the Kohn Defendants. MISL claimed that the Kohn Defendants, therefore, held the payments (and their traceable proceeds) on constructive trust for MSIL.

BLMIS issued a separate claim against the Kohn Defendants; in which it pleaded that as a matter of New York Law, the Kohn Defendants received and held the BLMIS payments as constructive trustees and/or were liable to make restitution, on the basis that it would be inequitable for them to retain the monies. Flaux J recognised the significant factual overlap between the MSIL and the BLMIS claims against the Kohn Defendants.

THE APPLICATIONS IMMEDIATELY BEFORE THE COURT

The Kohn Defendants applied to the English Court to set aside the proceedings brought against them by BLMIS on the grounds that the English court did not have jurisdiction to hear the BLMIS claim. The Kohn Defendants accepted that the English court had jurisdiction to hear the MSIL claim, pursuant to Article 6.1 of EC Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the "Judgments Regulation").

MSIL applied to the Court for a freezing injunction and/or a proprietary injunction against the Kohn Defendants.

THE JUDGEMENTS REGULATION AND "ANCHOR DEFENDANTS"

Article 2 of the Judgements Regulation states that a defendant must be sued in the courts of the (European Union) Member State in which he is domiciled, unless certain exceptions apply. One such exception is found in Article 6.1 of the Judgements Regulation, which provides that a person (i) domiciled in a Member State; and (ii) sued as one of a number of defendants; may be sued in the courts of the place where any one of the other defendants (the "Anchor Defendant") is domiciled. However, this exception only applies if the claims are *"so closely connected that it is expedient to hear and determine them together to avoid risk of irreconcilable judgments resulting from separate proceedings"*. This means that, under Article 6.1, if a claimant sues a defendant who is domiciled in England (the Anchor Defendant) then that claimant can join other relevant defendants who are domiciled in other European Member States to the claim.

The question before the Court (on which there is no prior European or English case law) was whether the same "anchoring" applies where the Claimant seeking to invoke Article 6.1 (BLMIS) does not in fact have a claim against the English domiciled defendants, but where another claimant with a similar claim (MSIL) is suing all the relevant defendants.

THE ARGUMENTS ON JURISDICTION

The Kohn Defendants argued that since the payments made to them by BLMIS had been made directly to Austria, the BLMIS claim should be heard in the Austrian courts (or alternatively in the Swiss courts as Mrs Kohn spent much of her time there).

They submitted that as BLMIS had no claim against the English Anchor Defendants (the directors of MSIL), Article 6.1 of the Judgements Regulation did not apply.

BLMIS argued that Article 6.1 of the Judgements Regulation did apply because there was a claim before the English court against a number of defendants domiciled in the UK based on essentially the same allegations of (i) breach of fiduciary duty by the directors; and (ii) knowing receipt by the Kohn Defendants. In addition, Mrs Kohn's defence to the two claims would be the same, namely that all payments were by way of commission and therefore above board. BLMIS relied heavily on the underlying purpose of Article 6.1, which is to prevent irreconcilable judgements (in this case between England and either Austria or Switzerland).

THE DECISION

The Kohn Defendants' application was successful and the BLMIS proceedings against them were set aside. Flaux J held that the English court did not have jurisdiction to hear the BLMIS claim because **Article 6.1 of the Judgements Regulation only applies where the same claimant is suing both the English domiciled Anchor Defendant and the defendants domiciled elsewhere**.

The English Court had jurisdiction to hear the MSIL claims against the Kohn Defendants because MSIL was also suing the English domiciled directors. However, the Judgements Regulation did not apply to BLMIS as it was not making any claim against the English domiciled directors. It was therefore irrelevant whether or not the English Court's and Austrian/ Swiss Court's decisions might produce irreconcilable judgments. Flaux J acknowledged that although it made sense in terms of case management for the English Court to hear the MSIL and the BLMIS claims together, it simply could not do so because it had no jurisdiction to hear the BLIMS claim.

COMMENT

This case provides useful guidance on the scope of Article 6.1 of the Judgements Regulation where a claimant seeks to invoke jurisdiction under the Judgements Regulation but is not personally pursuing a claim against an English domiciled Anchor Defendant. The English court is clear that Article 6.1 does not allow a claimant who has no claim against the Anchor Defendant to "piggy-back" onto a claim by another claimant. Therefore if BLMIS wished to pursue these claims it would have to do so in the foreign jurisdiction where the Kohn Defendants are domiciled. Had the BLMIS claim also been brought against the English domiciled directors, the prospect of irreconcilable judgements would have been more important.

POSTSCRIPT

Although the claim against the Kohn Defendants brought by BLMIS was set aside, the freezing order and the proprietary injunction applied for by MSIL were granted. Flaux J held that the claims of knowing receipt by the Kohn Defendants of monies which the MSIL directors had paid out in breach of their fiduciary duties meant that there were serious issues to be tried between MSIL and the Kohn Defendants and, therefore, on the balance of convenience, the proprietary relief and the freezing injunction should be granted. Flaux J was swayed in his decision by the lack of proper disclosure by the Kohn Defendants and he believed that there was a real risk of dissipation of assets by them. Therefore, although the Kohn Defendants managed to avoid the BLMIS claim, their victory on that aspect may have been somewhat pyrrhic. This is even more so because BLIMS is also suing the Kohn Defendants in New York, in any event.

CONTACT DETAILS

If you would like further information or specific advice please contact:

IAIN MACKIE
iain.mackie@macfarlanes.com
DD: +44 (0)20 7849 2299

PAUL DAVIES
paul.davies@macfarlanes.com
DD: +44 (0)20 7849 2536

BARRY DONNELLY
barry.donnelly@macfarlanes.com
DD: +44 (0)20 7849 2950

DAN LAVENDER
dan.lavender@macfarlanes.com
DD: +44 (0)20 7849 2606

CHARLES LLOYD
charles.lloyd@macfarlanes.com
DD: +44 (0)20 7849 2338

WILLIE MANNERS
willie.manners@macfarlanes.com
DD: +44 (0)20 7849 2284

MATT MCCAHEARTY
matt.mcCahearty@macfarlanes.com
DD: +44(0)20 7849 2659

SIMON NURNEY
simon.nurney@macfarlanes.com
DD: +44 (0)20 7849 2405

GEOFF STEWARD
geoff.steward@macfarlanes.com
DD: +44 (0)20 7849 2341

DOUGLAS WASS
douglas.wass@macfarlanes.com
DD: +44 (0)20 7849 2569

JANUARY 2012

MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT

T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com