GARNET – A NEW INVESTIGATORY ROLE FOR THE BANKS?

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The decision of the Court of Appeal in the matter of The Chief Officer, Customs & Excise, Immigration and Nationality Service -v- Garnet Investments Limited could have wide ramifications for the banking industry and those regularly subject to the reporting regimes under the Criminal Justice (Proceeds of CrimeHBailiwick of Guernsey Law 1999 (the Proceeds Law).

The Court of Appeal in Garnet has set out its view that the burden of demonstrating whether or not the funds a bank holds are 'tainted' fall on the bank, rather than its customer or the Financial Intelligence Service (the FIS).

Background - the anti-money laundering regime

The Court of Appeal reversed the first instance decision on almost every point.

The main issue, both at first instance and appeal, was the effect of the FIS's refusal to provide consent. Garnet argued that a refusal by the FIS to provide consent to a transaction allowed the FIS to effect an informal freezing order over funds, as no bank (or other institution) would transfer funds without this consent as it would otherwise be guilty of a criminal offence.

At first instance the Lieutenant Bailiff agreed with Garnet. However, the Court of Appeal found that *"it is not the FIS denying Garnet access to its property and preventing judicial oversight, it is the impact of the width of the criminal law and its chilling effect upon the person holding the fund, namely BNP."*

The Court of Appeal went on to state that the refusal of consent does not prevent judicial oversight by the courts as the *"legality of any refusal to transfer funds may be challenged by a private law claim brought against the person holding the funds before the Courts of the Bailiwick"*.

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> — The Court of Appeal

"Garnet has not been put in the position of having no means whatsoever of dealing with its property, namely, the right to demand payment under the banking contract. The ability to enforce that contract is a matter of civil law. Put simply, only if the bank can establish a relevant defence will Garnet fail to obtain repayment of its funds. Doubtless the bank would defend the proceedings but the existence of the lack of consent under Section 39(31 would not be relevant as a defence to that claim. The parties would be

joined on an issue or issues as to whether or not the funds were tainted and it seems to us likely as we have indicated above that the burden of proof - to the civil standard of balance of probabilities - would be upon the bank to show that the funds were indeed tainted."

The Court of Appeal did however find that, as a matter of principle, the decision of the FIS was subject to judicial review and that whilst the FIS were under not under a general duty to give reasons for their decisions in all circumstances, where it is possible there are important policy and practical reasons for reasons to be given.

However, it would appear that the threshold required by the FIS to reasonably refuse consent is not significant, the Court of Appeal commenting*: "where there is a suspicion that has not been dispelled, the police must be entitled to refuse consent whatever period of time has elapsed" relying upon the comments of Tomlinson J4 "It seems clear... that the existence of a suspicion is sufficient to ground a proper refusal of consent".*

It therefore appears that the Court of Appeal considers a suspicious transaction report by a bank to be sufficient grounds in itself for the refusal of consent by the FIS.

On this basis the Court of Appeal found that the decision of the FIS to refuse consent was not irrational or disproportionate and did not interfere with Garnet's rights.

The effect of the court of appeal decision in Garnet

The current anti-money laundering regime (quite rightly) promotes a caution when managing this risk to institutions and an 'if in doubt, report it' approach. This Judgment must not affect the reporting and risk management policies and procedures of those organisations when dealing with potential anti-money laundering issues.

However, the effect of the Court of Appeal's decision appears to:

1. put banks and other service providers in an unenviable position of having to assert its own client's funds are tainted once a report has been made an consent refused; and
2. potentially remove the FIS from final determination as to whether those funds are, or are not tainted, notwithstanding the FIS's own mandate to combat and prevent financial and economic crime, as the civil court determines this issue as a matter of contract law

Unfortunately it was not addressed by the Court of Appeal but there is a question whether, without FIS consent, in paying out any money on the basis of a court order the bank is still committing a criminal offence as it is not a defence under the Proceeds Law to make a payment with the consent of the court, only a police officer.

Practically speaking...

Banks and other service providers should look to review their client mandates to ensure that they manage, to the extent possible, the risks posed by customer actions where FIS consent has been refused. In particular consider whether their mandates operate so as to provide the organisation with an ability to disregard instructions where the organisation has a suspicion under the Proceeds Law (and

the FIS has refused consent).

In effect the Court of Appeal decision has placed the burden of proof in demonstrating that the funds are tainted on the reporting body (when it is being sued by its customer) or the customer (when he is seeking judicial review of the decision of the FIS).

Is that all?

No, not really. The Court of Appeal considered that Guernsey does not have the same level of fast moving transactional business that might be damaged by an absence of deemed consent (i.e. that a continued failure to provide consent (and take no other actions) could become increasingly unreasonable). Instead the Court believed Guernsey's financial system is more concerned with the stable administration of funds through third party managers or trustees. However, while apparently recognising this distinction it failed to deal with the practicalities of this system in its own judgment.

The circumstances of Garnet only involved two separate parties: BNP holding the funds which may or may not be tainted and maintaining its suspicions and Garnet demanding the funds. In this case, as the Court of Appeal envisaged, the party demanding the funds could issue proceedings against another party, i.e. Garnet had a cause of action under its bank mandate.

But what if the parties, unlike Garnet, did not have an absolute entitlement to the funds, for instance discretionary beneficiaries? In these circumstances the trustees would be in a position where they were required to instigate proceedings, either by artificially suing themselves (as the party with the right to the property and the party holding the property) or judicially review the decision of the FIS (as potentially the only party with standing) in circumstances where they are aware the threshold for the FIS to demonstrate reasonableness is low.

Final thoughts

As an international financial centre Guernsey must rigorously maintain high standards expected by the international community and the Proceeds Law is one tool in the legislature to enable the various bodies to enforce this.

However, in adopting a more restrictive approach than in other, similarly principled jurisdictions (for instance lack of ability to disclose with consent, or deal with funds after the elapse of time) the current Proceeds Law also has the effect of restricting a bank's ability to manage its own risk, reducing its options (and to an extent those of the FIS) and increasing the likelihood these matters will end up at court.

Guernsey, in response to its position as a major offshore financial centre and to maintain its regulatory reputation introduced the Proceeds Law to enable it to "deter criminals from attempting to use the Bailiwick for the purpose of laundering the proceeds of crime".

The relevant provisions of the Proceeds Law are sections 38, 39 and 40, which between them create a wide-ranging prohibition on money laundering the proceeds of crime.

These sections operate so as to make it an offence for an institution to transfer, convert or disguise any property which they know or suspect may be the proceeds of criminal activity

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or provide assistance or enter into arrangements where this may be the effect.

Under these sections a defence is available to the institution if it reports its suspicion or belief to the police and obtains consent for any proposed arrangement. It is this provision of consent by the police (or lack thereof) that is the subject of the decisions in *Garnet*.

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The circumstances of Garnet

Garnet Investments Limited was a company incorporated in the BVI in 1998. The beneficial owner of Garnet is Mr Hutomo Mandara Putra, the son of the former President of Indonesia. Between 1998 -1999, shortly after his father resigned. Garnet received various payments totalling US$60million and £8million.

Following the resignation of his father corruption charges were brought against Mr Hutomo and in September 2000 he was sentenced to 18 months imprisonment and fined 30.6 billion Indonesian Rupiahs. He went on the run and in 2002 was convicted of murder, fleeing justice and illegal possession of firearms (although the corruption charges were quashed in 2001). He was sentenced to 10 years and was released in 2006.

In October 2002 Garnet instructed its bank (BNP Guernsey) to transfer funds of approximately €36.46 million from its accounts. BNP refused. It notified the FIS of the instructions and requested its consent to the transfer. The FIS refused consent to BNP to act on those instructions.

Further transfer requests were made by Garnet, some of which were refused, one of which the FIS consented to. As a result of the refusals to comply with the transfer requests Garnet issued proceedings against BNP. During the course of the proceedings BNP relied on (among other things) its disclosure under the Proceeds Law and the FIS's refusal; to defend itself against the proceedings (on the basis that to have acted otherwise would expose BNP or its employees to criminal liability).

In 2007 the Indonesian government joined the proceedings and obtained a freezing injunction in respect of the Garnet accounts. This was subsequently discharged by the Court of Appeal in 2009 and an application for appeal by the Indonesian government to the Privy Council was dismissed.

In 2009 Garnet made a further request for transfer of funds to BNP and wrote to the FIS detailing why the payment should be made. The FIS refused to provide consent to BNP to carry out the transfer.

In response to the FIS's refusal Garnet issued proceedings for judicial review of the FIS's decision.

At first instance, in February 2010 Lieutenant Bailiff Newman gave judgement in favour of Garnet, holding that the decision of the FIS to withhold consent amounted to a freeze of the assets without formal process and its continued refusal was therefore irrational and disproportionate, constituting an excessive interference with Garnet's property rights and a breach of Article 1 of Protocol 1 to the European Convention on Human Rights.

The FIS appealed the decision and the Court of Appeal allowed their appeal.

The Garnet court of appeal decision

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