

WHEN IS SUSPICION REASONABLE?

1. N2J and Ace Telecom Trading Ltd -v- Cater Allen, (Unreported, 21 February 2006) is another recent English High Court judgment in relation to Part 7 of the UK Proceeds of Crime Act 2002 which considers the reasonableness or otherwise of a suspicion for the purposes of the Act. This briefing summarises the case and considers the implications for those who operate within the financial industry.

FACTS

2. N2J and Ace Telecom ('the Claimants') applied for a mandatory injunction against the Defendant, a bank, when the Defendant failed to honour payment instructions given by the Claimant on 7 and 8 February 2006. In essence the Claimants wanted the court to order the Defendant to honour the payment instructions that it had received.
3. The Claimants are related wholesale traders of, mobile phones, phone accessories, computers and related peripherals. For the seven months between June 2005 and December 2005 N2J had a turnover of £33.25 million, gross profits of £1.66 million and net profits of £1.5 million. Due to the volume of goods traded by N2J it often requested large repayments of VAT from Her Majesty's Revenue and Customs (HMRC). HMRC generally did not question the repayments. However in relation to the claim in October 2005 for £2,000,513.03 which was paid in three tranches, HMRC required repayment in the sum of £1,163,718.20. Despite this request for repayment a further payment of £998,000 was made to the Claimant's bank by HMRC on 16 February 2006 and HMRC has remitted various payments, and permitted payments to be made, whilst refusing others, before and after, 8 February 2006.
4. The dispute between the Claimants and the Defendant arose when the Defendant refused to honour eight payment instructions given by N2J on 7 and 8 February 2006. Six of these instructions requested payments to accounts in the United Kingdom, totalling £185,000, and one was an international transfer of £716,000 to the N2J account at First Curacao International Bank NV. None of these transfers have been carried out.
5. The payment of £716,000 was urgent since it was needed to make payment to suppliers and non-payment, or delay in payment, would have had potentially adverse consequences for N2J's trading.
6. The Defendant had informed HMRC, pursuant to the Proceeds of Crime Act 2002, that it knew or suspected that the funds that were to be paid out on 7 and 8 February 2006 were criminal property. If it had failed to inform HMRC when it knew or suspected that monies that it held were criminal property then it would have committed an offence under section 328 of POCA 2002, unless it made an authorised disclosure to a Constable or Customs Officer under section 338. Once an authorised disclosure has been made the Defendant would only have been able to make a transfer if it had the appropriate consent from the Constable or Customs Officer, under section 328(2)(a).
7. HMRC, having received the Defendant's disclosure, considered the matter and refused consent for the transfer transactions on 14 February 2006. Consent would be deemed to have been given if a refusal is not received within seven working days, or if a notice of refusal of consent is served, after a moratorium period of 31 days from the receipt of the refusal notice, section 335(2), (3) and (4). The Defendant would have committed an offence under section 328 if it had authorised the transfers during the 31 day moratorium period which commenced on 14 February 2006.
8. The Defendant had not informed the Claimant of the reason behind its decision not to transfer the monies because to do so it would have committed an offence under the 'tipping off' provisions: section 333.

THE CLAIMANTS' SUBMISSIONS

9. The Claimants urged the court to order the mandatory injunction on the basis that its case was exceptional. They submitted that there was no proper basis for the Defendant's suspicion, and alternatively, the Claimants had a good arguable case that the Defendant in fact lacked the requisite suspicion. The Claimants argued that the Defendant should disclose the nature of its suspicion before the court, and in the absence of the Claimants, the court could judge whether there were in fact grounds for suspicion, or whether instead the Defendant was acting out of cautiousness or fear of prosecution or simply speculating that there was suspicion when in fact there was none.

THE DEFENDANT'S SUBMISSIONS

10. The Defendant's case was that pursuant to its contract with the Claimants it was entitled to refuse to honour a transfer where it was not reasonably satisfied that the transaction(s) in question were lawful. The Defendant further submitted that the refusal to give consent to the transactions by HMRC established the reasonableness of their suspicion. Therefore either the Defendant had a relevant suspicion under the POCA regime, or alternatively, it was not reasonably satisfied of the lawfulness of the transaction under its banking contract.

HMRC'S SUBMISSIONS

11. HMRC, acting as an intervener, submitted that the seven day period and the 31 day moratorium provided adequate protection. There was no need for the court to intervene. If the trader were able to ask the court to intervene in every case then this would frustrate the purpose of Part 7 of POCA.

THE JUDGE'S RULING

12. The Judge noted that all parties agreed that the Defendant's suspicion was a subjective rather than objective question. He referred to the case of *Hussein v Chong Fook Kam* [1970] AC 942 'Suspicion in its ordinary meaning is a state of conjecture or surmise where proof is lacking, 'I suspect but I cannot prove'. Suspicion arises at or near the starting point of an investigation of which the obtaining of prima facie proof is the end'.
13. The Judge refused to accept that the Claimants' case was, in anyway, exceptional. In his judgment suspicion did not necessarily have to have a long history of misdoing before it arose. A suspicion could arise where there had been an otherwise seamless period of good conduct by a customer and then one important piece of new information would come to light causing the suspicion to occur. The fact that HMRC had made past, or even subsequent, repayments to the Claimants did not necessarily mean that there were no grounds for the Defendant's suspicion.
14. The Judge accepted that Parliament had addressed the deficiencies in the previous legislation: the Criminal Justice Act 1993 and the Criminal Justice Act 1988, and had introduced protection for the customer by the creation of the seven day period and the 31 day moratorium (see generally *C v S, Money Laundering, Discovery of Documents* [1999] 1 WLR 1551). The tension between the private interest (freedom of commerce) and the public interest (combating crime) had been resolved via the introduction of Part 7.

15. The refusal of consent by HMRC was not neutral in its impact. On its face it gave rise to the inference that HMRC considered that there was sufficient merit in the Defendant's suspicion to mount an investigation into some, albeit not all, transactions. The Judge stated that in his view this was an important factor in determining that there was no issue to be considered by the Courts in the present case and that there was no challenge which could be raised in the circumstances to the subjective view that the suspicion existed and was held by the Defendant.
16. The Defendant's assertion that under its contract it was not reasonably satisfied as to the lawfulness of the transaction was held to have been established. The Judge concluded that the Defendant's suspicion was prima facie made out by the actions of HMRC. In those circumstances the Defendant was entitled to rely upon its contract in defending the claim.
17. The Judge having concluded that the suspicion was reasonable was not prepared to make an order in favour of the Claimants with the effect that the Defendant would have to provide further information in relation to the claim. The court would not make an order which, as an inevitable consequence, would lead to the Defendant committing a criminal offence under section 333 'the tipping off offence'.
18. The Judge observed that grave practical difficulties would arise where a Court was forced to consider whether or not a subjective view of suspicion did in fact exist. To carry out such an enquiry would inevitably require an examination of documentation or alternatively the hearing of evidence, which may foreseeably prejudice any investigation that may be taking place. The Judge held that if this course of action were to take place then it would inevitably defeat the very purpose of the legislation. Where an investigation was in its very early stages it may well be disrupted or curtailed or otherwise impeded by an intervention of a court. The Judge expressly held that it would be 'difficult to know, in any event, when all that is required is suspicion as the trigger, especially where consent has been refused by HMRC, how the court would be able to conclude that such a subjective test had been failed'. Suspicion would often be no more than a feeling based on material which may fall well short of prima facie evidence.
19. In relation to the Claimant's claim for a mandatory injunction the Judge observed that damages would likely have been an adequate remedy in the absence of a risk of insolvency. The Judge expressly did not consider whether different considerations would have applied if a second 31 day period had commenced.
20. The Judge concluded that there were 'powerful public policy reasons for permitting an investigation which has been properly triggered by a disclosure into a common, widespread and serious, potential fraud to continue within the time frame created by the POCA regime. If a challenge to the procedure were made it can be by judicial review, not action against the financial institution who was obliged to make the disclosure under pain of prosecution. The check on an over cautious bank is firstly the HMRC itself, and secondly judicial review of the HMRC should they act improperly on the bank's or other institution's disclosure, or otherwise in conducting the matters once the investigation has started'.
21. Unsurprisingly in the light of the foregoing the Judge refused the Claimant's claim for a mandatory injunction. Comment
22. It is notable that the Judge in this case was prepared to introduce an external check and balance in relation to the nature of the Defendant's suspicion i.e. the actions of HMRC. It logically follows from this judgment that wherever a Constable or Customs Officer refuses consent in a case after a suspicion has been reported then this will constitute persuasive evidence, if not final evidence, in support of the reporting institution's suspicion.

23. It is certainly foreseeable that the external check and balance may well act harshly against future customers of a financial institution. In many cases it seems unlikely that the Police or HMRC will have had sufficient opportunity to investigate a report within the 7 working days initially envisaged by the legislation. It follows that in many cases consent will have to be refused. This refusal of consent may have significant financial consequences. Nonetheless it would appear that the court will not interfere and will allow the statutory regime to take effect subject to any judicial review of the Police or HMRC decision to refuse consent.
24. It is of some note that the Judge concluded that damages were an adequate remedy in the absence of a risk of insolvency. There may be cases where there is the presence of a risk of insolvency which may force the court to take a more interventionist line. Whether a first instance judgment that took such a line would be upheld on appeal is unclear. It would be dangerous to assume that an appellate court will allow a distinction to appear in law between those Claimants who merely risk financial loss and those who risk insolvency.
25. It is noticeable that the question of a second 31 day moratorium was deliberately left open. It may be that future cases will allow for greater judicial involvement within this sphere, though given that Parliament has directly legislated in this area it would be unwise to assume that the courts will take any particularly drastic steps.
26. The remedy of judicial review will inevitably have a limited effect. It is certainly difficult to conceive of circumstances when the Police or HMRC will be found to have acted unreasonably by simply refusing consent (assuming no malice or negligence on their part). As the Judge stated in the course of his judgment it is difficult to see how any court based investigation of this situation could be achieved without prejudicing any Police or HMRC investigation that may, at that time, be in train. Further, given the threshold in question – mere suspicion – how likely is it that a reviewing court will conclude that a decision to refuse consent was in fact unreasonable?
27. Assuming that financial institutions act reasonably and only report in cases where they have a genuine suspicion then the legislation will work appropriately. Some may be concerned that the POCA regime gives excessive protection to financial institutions at the expense of the customer (the mere 'suspicion' test), however one must bear in mind the reputational consequences in the market place if a financial institution is seen to be, or perceived to be, over using the legislation. The reputational fall out in terms of potential loss of business will act as a market based incentive not to over use, or perceived to over use, the legislation.
28. The best advice for all parties involved in financial transactions is to take time to communicate. A financial institution that knows and understands its customer's business is far less likely to form a suspicion about the transactions that it undertakes. Indeed were a financial institution to have a better understanding of its clients then identifying the truly suspicious transactions will necessarily be made easier. This case highlights, yet again, the vital importance of having, and actually applying, a KYC policy. It is the application of such a policy that will greatly assist in ensuring that customers and institutions avoid unnecessarily falling foul of the legislation with all of the consequences that that would entail.

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