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U.S. SEC Obtains Asset Freeze In United Kingdom Against U.K. Citizen Who Is Principal Of SEC-Registered Hedge Fund

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On June 18, 2008, the U.S. Securities and Exchange Commission obtained an order from the High Court of Justice in London freezing assets held by a U.K. citizen who is a principal of an SEC-registered hedge fund advisory firm *(see WSLR, June 2008)*. This is only the second time in recent memory that the SEC — in its own name — used a foreign court to freeze assets of a foreign national during the pendency of a U.S. enforcement case. Also of significance, the High Court determined — as a matter of first impression in the United Kingdom — that the SEC is not required to give a "cross-undertaking" to cover any damages that might result from the asset freeze.

The SEC's Activities In The United States

On April 12, 2007, the SEC filed an enforcement action in U.S. District Court against three defendants: Lydia Capital, LLC, a registered investment adviser based in Boston, Massachusetts; and its two principals — Evan Andersen, also of Boston; and Glenn Manterfield, a U.K. citizen and resident of Sheffield, England. The case, *SEC v. Lydia Capital, LLC et al.*, arises from allegations that Manterfield and Andersen engaged in a scheme to defraud more than 60 investors who invested approximately U.S.$34 million in a hedge fund managed by Lydia Capital.

The SEC filed its complaint along with various requests for emergency relief, including a motion for an order freezing assets. On April 12, 2007, the District Court granted the SEC's requests for emergency relief and issued an order freezing the three defendants' assets.

The SEC's Activities In The United Kingdom

When the SEC filed its enforcement action, Manterfield's assets were already frozen in the United Kingdom. In February 2007, the South Yorkshire Police in England had obtained an order freezing Manterfield's assets in connection with a fraud investigation that was related to the same conduct that is the subject of the SEC's enforcement action. But approximately one year

later, the South Yorkshire Police decided to close its investigation — a move that would result in the discharge of the freeze order.

The SEC Applies For An Asset Freeze In Its Own Name

Upon learning that the freeze order would be lifted, the SEC took action:

- The SEC contacted the U.K. Financial Services Authority ("FSA"), which provided background information and guidance regarding the British legal landscape. The FSA, however, was not a party to the litigation and did not file any documents in the case.
- The SEC retained a solicitor and a barrister to represent it in the English court system.
- On February 29, 2008, the SEC — in its own name — filed an application with the High Court of Justice, Queen's Bench Division, seeking an emergency order freezing Manterfield's assets. The SEC informed the High Court that the existing freeze order "is likely to be discharged early next week" and explained that a freeze order is necessary because "there is a real risk that the Defendant will dispose of his assets before the determination of the U.S. proceedings, thereby preventing the [SEC] from enforcing any judgment it may obtain in the U.S. proceedings against the Defendant."

On the same day, the High Court issued an order temporarily freezing the assets. On April 30, 2008, and May 1, 2008, evidentiary hearings were held in the High Court to determine whether the freeze should be extended.

A Question Of First Impression In The United Kingdom

The evidentiary hearings focused on whether a freeze order should issue. Ordinarily, answering this question involves a relatively straightforward analysis. English courts generally ask two questions: 1) whether the applicant has "a good arguable case"; and 2) whether there is "a real risk of dissipation." If the answer to both questions is "yes," a freeze order typically issues.

But this was not an ordinary application. Because the SEC had applied for a freeze order in its own name, the High Court was confronted with a question of first impression with particular significance to the SEC's ability to conduct overseas enforcement activities in England: Must the SEC — a non-U.K. law enforcement agency — provide a "cross-undertaking in damages" to the Court?

In England, an applicant who seeks an interim injunction — including an order freezing assets — generally must provide a "cross-undertaking in damages." A cross-undertaking is normally regarded as the "price" of an injunction, and it works like a bond: The applicant seeking the freeze "undertakes" to pay the damages of the person whose assets are frozen if it is later determined that the freeze should not have been ordered in the first instance.

While an applicant seeking a freeze order usually has to provide a cross-undertaking in damages, there is an exception to this general rule: Where a U.K. law enforcement agency seeks to freeze a person's assets, the courts have discretion to dispense with the cross-undertaking requirement. The question of first impression before the High Court was whether this exception (called the Dispensation Rule) should be extended to the SEC — a non-U.K. law enforcement agency.

The question was important. The SEC had conceded that it could not provide a cross-undertaking in damages due to the U.S. Antideficiency Act, 31 U.S.C. § 1341, which seeks to prevent a U.S. governmental agency from agreeing to an obligation in a dollar amount not previously authorized or appropriated. Consequently, if the High Court found the Dispensation Rule inapplicable and ruled that a cross-undertaking were required, the SEC would not have been able to provide it; and without a cross-undertaking — the "price" of an injunction — the SEC could not obtain a freeze order.

Accordingly, the SEC argued that it should benefit from the Dispensation Rule. The SEC maintained that it is "a public body seeking to enforce the law." The fact that it is a non-U.K. public body, the SEC posited, should not make a difference in the analysis because it is an arm of a "foreign friendly state," and "considerations of comity militate against demanding a cross-undertaking from a foreign governmental body when the English Court would (or at least might) not require a cross-undertaking from the U.K. equivalent of the SEC."

Among other arguments, Manterfield countered that the SEC should not benefit from the Dispensation Rule because the SEC is not funded by the British taxpayer; the subject matter of the action took place outside of Britain; and the SEC has not alleged that the interests of U.K. citizens were adversely affected by the alleged conduct since all but one of the allegedly defrauded investors were Taiwanese nationals.

In an oral ruling on May 16, 2008, and in a written opinion issued on June 18, 2008, the High Court ruled in favor of the SEC. The Court extended the Dispensation Rule to the SEC and dispensed with the cross-undertaking requirement. The Court reasoned that the "fraudulent activity of the kind allegedly engaged in by Mr. Manterfield is an international problem requiring international co-operation . . . . Bodies like the SEC in the U.S. and comparable institutions in other countries exist in order to further the objective of combating fraudulent conduct." The Court continued the freeze of Manterfield's assets until the resolution of the SEC's pending enforcement action in the United States. As a result of this ruling, the SEC will not be required to cover any damages that are caused by the freeze order if it is later determined that the order was improperly granted.

Comment

While it is fairly common for the SEC to freeze assets of foreign nationals in U.S. courts, this is only the second time in recent memory that the SEC — in its own name

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— sought an asset freeze in a foreign court against a foreign national. In the only other known case, the SEC obtained a freeze order from the Eastern Caribbean Supreme Court in Montserrat in 2005. There is little documentation on that case, making it difficult to explain what may have compelled the SEC to take such action.

With respect to the present case, however, the SEC's decision to seek an asset freeze in the United Kingdom in its own name may be explained by several factors:

No Enforcement Interest

Given that the South Yorkshire Police decided to close its related fraud investigation of Manterfield and allow the freeze order to dissipate, the FSA may not have had an enforcement interest in the case.

Lack Of Time

The SEC acted in an emergency fashion, filing its application only days before the existing freeze order was set to dissipate. Time constraints may have rendered impracticable the type of communication and coordination necessary to ensure the FSA's active participation.

Type Of Allegations

The SEC may have determined that, with or without the FSA, it should seek a freeze order given the type of allegations in the underlying action: The allegations reveal particularly egregious, large-scale international fraud by a principal of a U.S. hedge fund manager and his co-defendants.

Perhaps based on the factors articulated above, the SEC may limit the occasions on which it seeks to freeze assets of a foreign national in a foreign court in its own name. The SEC may find it sensible to limit the use of this approach given the commission's unfamiliarity with foreign law and the substantial costs associated with hiring private foreign counsel and litigating in foreign courts.

On the other hand, the SEC's success in the High Court of Justice may encourage the commission to develop more experience with this procedure and firmly establish it as one of the commission's array of international enforcement tools. In ruling that the SEC was not required to provide a cross-undertaking in damages, the High Court strengthened the ability of the SEC to conduct overseas enforcement activities in England and possibly other countries with a similar cross-undertaking requirement, such as Canada. Should this be its objective, the SEC may extend its reach to foreign countries more often and in cases that may not be as compelling as *SEC v. Lydia Capital*. Moreover, given that a freeze order is only one type of interim injunction for which a cross-undertaking is generally required, the SEC may use its experience in the asset freeze context to seek other kinds of overseas interim injunctive relief in connection with a potentially diverse range of matters.

It can be expected that future overseas enforcement activities will shed further light on the SEC's approach to these cases.