

PREVENTING MISUSE OF PUBLIC AUTHORITY IN THE CORPORATE SECTOR



” A variety of illegal and semi-legal methods are used in different countries in corporate conflicts, in attempts to eliminate competition and in forced takeovers of legal entities.

Comparative Analysis

Protection of the Rights of Entrepreneurs in the Russian Federation from Corrupt Practices (PRECOP-RF)

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PRECOP-RF
Protection of the Rights of Entrepreneurs in the Russian Federation from Corrupt Practices

Technical Paper:
Comparative analysis on preventing misuse of public authority in the corporate sector

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Disclaimer:

This technical report has been commissioned by the PRECOP RF project team and was prepared by a team of experts. The views expressed herein are those of the experts and can in no way be taken to reflect the official opinion of the European Union and/or of the Council of Europe.

Abbreviations

AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
BGH	The Federal Court of Justice (Germany) [<i>Bundesgerichtshof</i>]
CCL	Corporate Criminal Liability
CE	Corporate Entity
CC	Criminal Code (also the Competition Commission of the United Kingdom in Box 17)
CCL	Corporate Criminal Liability
CCP	Code of Criminal Procedure
CEO	Chief Executive Officer
CoE	Council of Europe
CPA	Code of Administrative Proceedings
CPIA	Criminal Procedure Investigation Act
CPS	Crown Prosecution Service
EAT	Employment Appeal Tribunal (United Kingdom)
EBRD	European Bank for Reconstruction and Development
ECtHR	European Court of Human Rights
FAS	Federal Arbitration Courts (Russian Federation) or the Federal Antimonopoly Service (Russian Federation)
FATF	Financial Action Task Force
FSS	Federal Security Service (Russian Federation)
G8	Group of eight (leading industrialised countries)
GAV	Custody [<i>Garde à vue</i>]
GEIU	Grey Economy Information Unit (Finland)
GmbH	Limited Liability Company – Germany [<i>Gesellschaft mit beschränkter Haftung</i>]
GmbHG	Law on Limited Liability Companies – Germany [<i>Gesetz betreffend die Gesellschaften mit beschränkter Haftung</i>]
HM RC	Her Majesty's Revenue & Customs
IPRED	Intellectual Property Rights Enforcement Directive
LLC	Limited Liability Company
OECD	Organisation for Economic Cooperation and Development
OFT	Office of Fair Trading (United Kingdom)
OIA	Operational Investigative Activity
OIM	Operational Investigative Measures
SRO	Self-Regulatory Organisation (of insolvency practitioners)
StGB	German - Criminal Code [<i>Strafgesetzbuch</i>]
STS	Decision of the Supreme Court of Spain [<i>Sentencia del Tribunal Supremo</i>]
TFEU	Treaty on the Functioning of the European Union
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UN	United Nations
UNCAC	United Nations Convention against Corruption
UNCITRAL	United Nations Commission on International Trade Law
UNODC	United Nations Office on Drugs and Crime
ZPO	Code of Civil Procedure – Germany [<i>Zivilprozessordnung</i>]

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1 EXECUTIVE SUMMARY

A variety of illegal and semi-legal methods are used in different countries in corporate conflicts, in attempts to eliminate competition and in forced takeovers of legal entities. Typically the perpetrators are unscrupulous businesspeople or even organised crime groups. Occasionally public authorities are involved in such struggles either because the private adversaries misuse official procedures or the authorities misuse their powers and collude with some of the parties. Among the most dangerous areas of misuse are criminal inquiries and proceedings (for example, ungrounded and discretionary investigative actions including raids, seizure of documents) and court decisions (for example, ungrounded arrests or asset seizure orders, which facilitate illegal takeovers).

However, other areas are also prone to such abuse of power, for example the powers of administrative inspection can be misused in order to obtain confidential information about a company or to cause stress and disruptions of its activities. In particular, agencies with broad and intrusive powers (e.g. search and seizure) such as competition authorities constitute a risk area – especially if their decisions are routinely equipped with weak reasoning. Major threats to ownership rights occur where procedural gaps facilitate entries in enterprise registers based on fraudulent or otherwise invalid documents, or where officials in charge of such registers are themselves corrupt. Although entry of invalid information in the register usually does not render the underlying illicit activity legal, the corrupt data may facilitate a chain of illegal actions with results that can be hard to reverse.

A major vulnerability of companies is a possibility to bribe their management, which can lead to asset stripping, artificial accumulation of debt, initiation of insolvency proceedings, etc. Corporate corruption may induce also many other kinds of wrongdoing, which can affect competition, e.g. illegal sale of confidential information held by banks and other companies or extortion of unofficial payments by employees of retail chains from providers of goods.

Insolvency proceedings may be distorted by administrators who illicitly serve only the interests of one party and courts or other bodies that fail to ensure proper supervision. Ungrounded initiation of bankruptcy proceedings by tax authorities represents another type of possible misuse. Biased application of public procurement, tax, customs and other rules undermines competition, adds uncertainty for businesses and blocks new market entrants.

This paper reviews existing international standards and practices of member States of the Council of Europe, which are relevant for countering the said types of misuse.

The analysis makes extensive use of international legal and non-legislative standards. Against many types of abuse, the European Convention on Human Rights is the most relevant piece of international law in Europe¹. In relation to anti-corruption, the United Nations Convention against Corruption, together with the Council of Europe Criminal Law Convention on Corruption, provide the international legal standard, which is referred to repeatedly. Other important conventions are the Council of Europe conventions on laundering, search, seizure and confiscation of the proceeds from crime (and on the financing of terrorism) as well as the United Nations Convention against Transnational Organised Crime. Where appropriate, the analysis places issues also in the context of the European Union law.

¹ It is noteworthy that the relevance and importance of the ECtHR case law, concerning protection of property and investment in particular, has actually gone beyond the boundaries of Europe: references to ECtHR judgments and decisions can be increasingly found in the ICSID case law, see for example the decisions in the cases *Azurix corp v. Argentine Republic*, ICSID case No ARB/01/12, Paras. 311-312, or *TECMED v. Mexico*, Case No ARB (AF)/00/2. *Siemens A.G. v. Argentina*, Case No Art/02/8, at paras. 116-122. For a general overview, see: *Privatizing Human Rights: the Interface between International investment protection and Human Rights*, in August Reinisch and Ursula Kriebaum (eds.), *The law of International relations-Liber amicorum Hanspeter Heuhold*, Utrecht: Eleven international publishing, 2007, pp.165-189

Another source of relevant benchmarks is recommendatory standards such as recommendations of the Committee of Ministers of the Council of Europe:

- on economic crime;
- concerning liability of enterprises having legal personality for offences committed in the exercise of their activities;
- on the role of public prosecution in the criminal justice system;
- on good administration;
- on the access to information held by public authorities;
- on judicial review of administrative acts; and
- on alternatives to litigation between administrative authorities and private parties.

One should note also recommendations of the OECD Council on merger review and on regulatory policy and governance, recommendations and guidance of the Financial Action Task Force, and G8 best practice documents. Concerning insolvency procedures, relevant international guidance is found in the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights, the EBRD Insolvency Office Holder Principles and the UNCITRAL Legislative Guide on Insolvency Law.

Against this background, the paper reviews the practice of selected member States of the Council of Europe in prevention of misuse in fourteen areas divided into three major groups. The analysis keeps a particular focus on the Russian Federation. Based on a selective approach, cases for comparison are drawn from France, Germany, Italy, Latvia, Norway, Spain, Switzerland, Ukraine, the United Kingdom and other countries. The covered subject areas are:

Criminal Procedure

- Misuse in criminal investigation;
- Search, arrest of property, identification, freezing, management and confiscation of the proceeds of crime;
- Preclusive effects in criminal cases;
- Corporate liability for criminal offences;
- Liability for corruption in the private sector; and
- Overuse and misuse of the criminal law in the regulation of business activity.

Civil Procedure

- Procedural abuse;
- Interlocutory injunctions in civil matters;
- Preclusive effects in civil and commercial cases;
- Limits to the protection of good faith purchaser; and
- Misuse of insolvency proceedings;

Administrative Procedure

- Registration of legal entities and the role of notaries;
- Administrative inspections; and
- Implementation of competition policies.

This is not an exhaustive list of topics, those listed above represent areas of abuse that are most often used in cases of corporate conflict, elimination of competition and forced takeovers in the Russian Federation. The authors of the paper jointly prepared the preliminary selection of the topics based on their background knowledge about the most common forms of abuse in the Russian Federation and other member States of the Council of Europe. Then the selection was corroborated with a review of available analytical sources and literature to ensure that it is in line with the current state of knowledge by experts of the field (references to those sources are provided in the introduction of the paper and introductory paragraphs of thematic chapters).

The Constitution of the Russian Federation proclaims the observance and protection of human rights as the obligation of the State (Article 2), legal equality of citizens (part 2 Article 6), the unity of the economic area, free movement of goods, services and financial resources, support for competition, freedom of economic activity (part 1 Article 8), prohibits economic activity aimed at monopolisation and unfair competition (Article 34), guarantees State and judicial protection for the rights and freedoms of man and citizen (Articles 45 and 46).

In addition, it should be noted that the Russian Federation has a comprehensive national legal framework and policy against corruption. The Federal Law №273-FZ of December 25, 2008 “On countering corruption” (hereafter – the Anti-corruption Law) defines corruption as well as anti-corruption measures. Further anti-corruption provisions are found in decrees of the President of the Russian Federation, government and ministerial resolutions and guidelines as well as sectorial legislation. Several laws, in particular, the Criminal Code and the Code of Administrative Offences provide legal liability for corruption offences.

According to the Anti-corruption Law countering corruption entails prevention (detection and eradication of causes of corruption); detection and investigation of corruption offences; as well as minimisation and/or elimination of the consequences of corrupt offences. Corruption prevention includes such elements as promotion of the public intolerance towards corruption, anticorruption reviews of (draft) laws and regulations, qualification requirements for individuals seeking public office, sanctions for officials who fail to disclose their income and assets, oversight institutions, etc. The Anti-corruption Law sets out the concept of the conflict of interest in the public service and defines procedure for its prevention and management. Particular objectives and activities are defined in the national anti-corruption strategy and the anti-corruption plan (updated every two years).

Specific protection measures for entrepreneurs are found in such pieces of legislation as the Federal Law №294-FZ of December 26, 2008 “On the protection of the rights of legal entities and individual entrepreneurs upon implementation of the state control (supervision) and municipal control” as well as the Federal Law №78-FZ of May 7, 2013 “On commissioners for the protection of the rights of entrepreneurs in the Russian Federation”.

The main conclusions of this analysis are formulated as legislative and policy proposals and are compiled in a separate paper.

2 INTRODUCTION

This analysis was carried out within the project on “Protection of the Rights of Entrepreneurs in the Russian Federation from Corrupt Practices” (PRECOP RF). The work is mostly based on a desk review of legislative acts, case law and policy-analysis reports.

A variety of illegal and semi-legal methods are used in different countries in corporate conflicts, in attempts to eliminate competition and in forced takeovers. Correspondingly there are many different ways, in which the public authority is misused to assist such activities.

The range of means of, for example, the so-called corporate raiding includes many different options: it can be a purchase of shares (in order to collect a controlling stake) or theft of assets by using a fictitious purchaser. Procedural security measures (interlocutory injunctions, for example, in the form of freezing of shares) are another tool favoured by raiders. In the Russian Federation, according to the law such security measures are taken in cases when a failure to impose them will make it difficult or impossible to execute a court decision. However, at this stage, the judge does not have to request originals of documents. Photocopies submitted by the plaintiff suffice and some of these documents may be falsified.

Illicit corporate raiding is by no means a phenomenon exclusively of the Russian Federation. For example, Matthew Rojansky has identified four principal types of raiders’ methods in Ukraine:

“Raiders’ methods vary widely, not only from “black” to “white”, but across a diverse set of legal, economic and political instruments and contexts. While a case can be found in Ukraine to illustrate nearly every possible variation, the majority of cases fall into a handful of typologies: Forced bankruptcies or business crises, in which the raider takes advantage of the weakness imposed on the business to seize control; Corporate or minority shareholder attacks, in which the raider typically acquires a minority interest in the target company, and by means of a corrupt court decision, forged document, or other pressure, converts that interest into majority ownership and control of the company; Civil litigation, relying on corrupt courts to deliver judgments favourable to raiders, who then seek to collect on the judgment by taking control of the company; and Extortion, by way of anything from endless fines, inspections or other administrative pressure, to denial of a critical license or permit, to so-called “made to order” criminal cases (“zakaznye dela”), to outright physical threats or physical pressure. In most actual raids, elements of more than one methodology come into play, and raiders may also switch tactics during the course of an attack.”²

We see in this abstract the important role of corrupt courts, abuse of administrative authorities that carry out inspections, issue licenses/permits, and apply fines as well as set up criminal investigations. Also features such as the involvement of politicians (elected deputies) in the campaign against the company, which is the intended target of the takeover, and authorisation by executive bodies of the change of management in enterprises partially owned by the state are known.³ In other instances such abuses are made possible by the existence of legal loopholes or excessive formalism in the regulation of entrepreneurial activity which expose companies to a higher risk of violating the law, and correspondingly to regulatory and criminal sanctions.⁴

The misuse can be especially harmful in environments where it is used not by petty bureaucrats on their own but rather in favour of businesses linked to individuals with influence in politics or

² Rojansky, M. (2013) *Corporate raiding in Ukraine*. available at www.irex.org

³ Research Center of Corporate Relations (2006), *Raiding in Ukraine: problems and corrective measures [комментарий центра исследования корпоративных отношений, рейдерство в украине: проблема и пути решения]* available at www.advisers.ru/

⁴ Collective (2009), *Proposals to improve the efficiency of the fight against raiding (illegal seizure of property)*, Real Estate and Investments, Number 1 (38) [*Предложения по повышению эффективности борьбы с рейдерством (незаконным захватом собственности)*]. Журнал “Недвижимость и инвестиции. Правовое регулирование”, Номер 1 (38), Апрель 2009] available at <http://dpr.ru/>

administration. In the international practice it is not uncommon that administrative barriers impede competition in areas where certain senior government and political figures have interests. For example, a US State Department report on Armenia states that: “Major sectors of Armenia's economy are controlled by well-connected businessmen – some of them members of parliament or other high-ranking officials – who enjoy government-protected market dominance. This raises barriers to new entrants, limits consumer choice, and discourages investments by multinational firms that insist on partnering with politically-independent businesses.”⁵ The government may deploy occasionally “agencies, including the tax and customs services, against political or economic opponents”. Favouritism can manifest itself as, for example, procurement contracts for well-connected companies⁶ while discrimination manifests as a forced sale of a controlling stake to someone connected with the officials.⁷

The thematic approach of this analysis is innovative in the sense that there is no established field of study of the misuse of authority in relation to, particularly, corporate conflicts, elimination of competition and forced takeovers. Generally speaking, integrity and rule of law measures, which are meant to prevent such misuse, are grounded in the whole area of criminal procedure (and parts of material criminal law), administrative procedure, vast parts of civil law, the whole of the anti-corruption framework, and vast segments of fundamental human rights. In the absence of an existing applicable analytical framework and specific needs assessment, the scope of the study was determined by the experts, in consultation with the Council of Europe, during the early stages of the analysis.

The study does not use any set definitions of corporate conflicts, competition and forced takeovers. One of the reasons is that universally agreed definitions hardly exist and, for example, a term such as “corporate conflict” is not found in the legislation of the Russian Federation. Moreover real-life policies against misuse of public authority are not always adopted and implemented with the explicit goal of tackling exactly these business-sector related problems (exceptions are probably the adoption of particular measures in countries where illicit corporate raids have become worryingly common). Rather the approach is to identify junctures where conflicts between shareholders among themselves or between shareholders and their companies, market competition struggles, and attempts of hostile takeovers may obtain illicit character and be facilitated by regulatory gaps or malicious misuse of the public authority.

The report integrates three major bodies of analysis. The first is a review of mandatory and recommendatory international standards. The second is analysis on problems and features of the legislative framework and practice in the Russian Federation. The third is a review of the experience of other member States of the Council of Europe and particular instances of the good practice. This is reflected accordingly in the structure of the majority of chapters (although concerning a few themes separate international standards, relevant for just this theme, were not identified). Each chapter is preceded by a brief review of the types of misuse of the legal framework and misuse of public authority, especially with regard to the phenomenon of illicit corporate raiding.

The country case selection was based on several considerations in order to (i) identify the most important models found in Europe, (ii) cover both Western Europe and countries of the former Soviet Union, (iii) show unique approaches, (iv) make use of easier availability of data on certain countries. The latter aspect was important because the research was carried out without a possibility to survey national authorities with the help of questionnaires or request inputs from them in other ways.

⁵ US Department of State (2013), *Investment Climate Statement – Armenia* available at www.state.gov

⁶ Khazin (2012), *Corruption hinders development of competition in Russia [коррупция сдерживает развитие конкуренции в РФ]* available at <http://actualcomment.ru/>

⁷ Settles A. (2009), *Hostile Takeovers, Corporate Raiding, and Company Capture in Russia* available at <http://www.cipe.org>

3 CRIMINAL PROCEDURE

3.1 Misuse in criminal investigations

Authorities and public officials who carry out criminal investigations and prosecution have wide powers to interfere with rights of private persons – both physical and legal. In a well-regulated system, the use of such powers should be appropriately limited and subject to legal checks. However, in the majority of countries these powers are at least occasionally misused because of incompetence, negligence or malicious intent.

In Russia so-called “commissioned prosecutions” (*zakaznye dela*) are probably the most clear-cut examples of criminal legal abuse. The term has been used to refer both to criminal cases “commissioned” by third parties as a way of sabotaging business competitors and to criminal cases initiated by law enforcement for extortionate or other improper purposes.⁸ There is in fact a frequent overlap of corrupted commercial motives between these two types of cases, the techniques are similar and they raise common legal issues.⁹ Extortionate prosecutions have expanded to target legitimate businesses, a feat accomplished by the creative use of legal loopholes and ambiguities to create a threat of criminal prosecution, which would not otherwise exist. In other instances, violations committed in the framework of legitimate criminal investigations may simply find their explanation in loopholes in the current legislation and judicial practice. They nevertheless create disproportionate interferences with the ability of a company to carry out its business activity¹⁰ or with its right to peaceful enjoyment of property.

While bodies of preliminary investigation have wide powers to open a criminal investigation, gather evidence, exert pressure on the accused, accused individuals have more modest means to protect their rights, including the right to protection from unlawful prosecutions.

Common types of misuse include:

- Ungrounded discretionary investigative actions (including raids, seizure of documents), sometimes because the law sets vague criteria thereof¹¹ or because officials are involved in corrupt conspiracies¹²;
- Search and seizure, which either enable the unlawful seizure of confidential information or unnecessarily and disproportionately hamper operations of a legal entity, for example, because the operation is impossible without the seized items and the link between the items and the suspected crime is doubtful (see also Chapter 3.2)¹³;
- Ungrounded or vaguely grounded initiation of criminal investigations (commissioned criminal prosecutions¹⁴),
- Initiation of criminal investigations in cases that in substance represent civil disputes, e.g. between a shareholder and company management (see also Chapter 3.6);

⁸ Skoblikov, *Korrupsiya v. Sovremennoi Rossii* 33-34 (2009)

⁹ Thomas Firestone, *Armed Injustice: abuse of the law and complex crime in post-soviet Russia*. Denv. J.Int'l L & Pol'y Vol 38:4

¹⁰ Article 34 of the Russian Constitution states that «Everyone shall have the right to a free use of his abilities and property for entrepreneurial and economic activities not prohibited by law».

¹¹ Nadgrodkiewicz, A. (2009) *Evolving Corruption: Hostile Takeovers, Corporate Raiding, and Company Capture in Russia*, available at www.cipe.org/

¹² A. Fedorov (2010), *Raiding and corporate blackmail*, [*Рейдерство и корпоративный шантаж*], p.47 available at www.zahvat.ru/

¹³ Unlawful or illegal searches are often a typical step in the unlawful acquisition of confidential information on the target company or individual which is then exploited for the forced takeover. *Proposals to improve the efficiency of the fight against raiding (illegal seizure of property) (2009)*, Real Estate and Investments. Legal regulation, "Number 1 (38), [*Предложения по повышению эффективности борьбы с рейдерством (незаконным захватом собственности)*] available at <http://dpr.ru/>

¹⁴ Firestone, T. (2010). *Armed Injustice: Abuse of the Law and Complex Crime in Post-Soviet Russia*, available at <http://djilp.org/>

- Authorisation of investigative activities by officials who are not entitled to issue such authorisation or investigative activities such as wiretapping without authorisation altogether;
- Inadequate documentation of investigation activities.

Available judicial remedies do not appear to be effective. Overall, in Russia the rate of convictions is extremely high. Once an investigation has been opened, hopes for an acquittal by the courts are slim. According to available data¹⁵ only in 2011 one million judicial decisions were handed down by the courts. Of these only 712 were acquittals, which is less than 0.1 %.

According to a report¹⁶ on prison population in Europe, drafted by *Institut de Criminologie et Recherche Pénale* of the Lausanne University, the number of individuals detained for economic crimes in most European countries is on average a few hundreds.¹⁷

In Russia, data on individuals who have been detained or imprisoned for economic crimes varies across sources although the numbers (ranging from tens of thousands to more than 120.000¹⁸) are clearly bigger than any other CoE Member. The number of entrepreneurs who have been convicted for economic crimes in the past years is about 240.000.¹⁹ It is estimated that about 3.5 million of them, which is about every other entrepreneur, have been prosecuted.²⁰

Box 1. Generic example of corrupt misuse of investigative powers

Proceedings in cases of economic crime differ significantly from proceedings in other types of crime. Officials of operational inquiry periodically provide an investigator with material resulting from their inquiries and attempt to convince the investigator to open a criminal case without additional verification. Sometimes it proves that the “inquiries” were conducted with respect to a commercial organisation with an abusive intent. Once negotiations with the management of the enterprise about some illicit reward fail, the inquirers want to demonstrate to the non-cooperative businessman how they can make his/her life very difficult with the help of a criminal case. Meanwhile they try to show that their inquiries have not been in vain. In such cases, an in-depth verification of the supplied material usually shows the fictitious character of the crime allegation.

3.1.1 The Russian Federation

Misuse by operational-investigative authorities: Operational - investigative activity (OIA) is regulated by the Federal Law №144-FZ of August 12, 1995 (hereafter – the Law on OIA), which defines it as an activity carried out by the operational units of the State bodies authorised by the Law on OIA, within the limits of their powers, by carrying out operational – investigative actions in order

¹⁵ *In Russia, the judges are less than 1% former prosecutors, lawyers* [*В России судьями становятся бывшие прокуроры, адвокатов - менее 1%*] available at <http://polit.ru/>

¹⁶ Council of Europe (2010), *Annual Penal Statistics*, available at www.coe.int/

¹⁷ For example Czech Republic 3284, Finland 114, Greece 54, Ireland 44, Lithuania 725, The Netherlands 218, Norway 141, Poland 113, Romania 76, Spain 1646, Sweden 272, Turkey 3710 and UK 1565. The most notable exception is Germany with 8500 individuals detained in connections with economic crimes. Most likely this “record number” is due to the absence of corporate criminal responsibility.

¹⁸ Kommersant, (11 April 2012) *If It is true, it is a catastrophe*, [*Если это правда, то это катастрофа*] available at www.kommersant.ru/

BBC Russian Service, (5 July 2012), *How to plant business in Russia*, [*Расследование Би-би-си: как сажают бизнесменов в России*], available at www.bbc.co.uk/

Radio Mayak, (25 July 2012), *Russian Ministry of Justice estimates the number of convictions for economic crimes* [*Минюст России подсчитал число осужденных за экономические преступления*] available at www.radiomayak.ru/

V. Radchenko (2012) *Most inhumane court - for entrepreneurs* [*Самый негуманный суд — для предпринимателей*], Forbes Russia available at www.forbes.ru/

¹⁹ Sibnovosti, (24 May 2013) *President Putin asked amnesty for businessmen convicted of economic crimes* [*Президента Путина попросили объявить амнистию для бизнесменов, осужденных за экономические преступления*], available at <http://fed.sibnovosti.ru/business/>

²⁰ Rosyskaya Gazeta, (2011) *State Duma deputies offer amnesty to convicted of economic crimes* [*Депутаты Госдумы предлагают амнистию осужденных по экономическим преступлениям*] available at www.rg.ru/

to protect the life, health, rights and freedoms of man and citizen, property, ensure security of the society and State against criminal encroachments.

Box 2. Example of ungrounded criminal persecution

“Owners of chemical business were persecuted by officials of Federal Drug Control Service (FSKN) using Article 234 of the Russian Criminal Code. Owners of chemical company NPK “Sofeks”, after turning down the offer from FSKN officials to supply drug manufacturer in Tajikistan with necessary chemical components in June 2004, were accused of illegal distribution of the so-called “virulent” substances and put in pre-trial detention in July 2006. The absence of a statutory definition of “virulent substances” allowed investigator to declare the chemical solvent “diethyl” being a “virulent” substance simply based on the results of the FSKN internal expertise. Expert concluded “diethyl” being a strong medication with an ultimate draught of 1 ml even though it is widely used as an anaesthetic. Regardless of public outrage and State Duma deputies’ appeal to prosecutor, subjects spent 7 months in prison until the trial. The court sorted out that FSKN’s expertise contradicted basic chemistry laws and released subjects from custody in February 2007. This case is among 0.2% share of trials ended in acquittal in Russia.²¹

In recent years, there has been a rise in the number of cases where courts have excluded evidence obtained through the analysis of material from operative investigative measures (hereafter OIM). This particularly happens in cases relating to corruption, fraud, drug trafficking, etc., where initiation of cases is preceded by an operational inquiry.

Article 89 of the Code of Criminal Procedure stipulates that findings of the OIA may not be used as proof if they do not meet the requirements for evidence. To obtain such status, they have to be introduced in the criminal proceedings in compliance with a strictly established procedure, which is provided in the Code of Criminal Procedure as well as in interagency legal acts (first of all in the regulations approved by the Interior Ministry, the Federal Security Service, the Federal Service of Guard, the Federal Customs Service, the Federal Service for the Execution of Sentences, the Federal Drug Control Service, and the Ministry of Defence of the Russian Federation on 17 April 2007).

Review of court practice shows recurrent violations of the same kind in the activities of the employees of operational-investigative units, which are either not appreciated by investigators, heads of the investigative bodies, supervisory prosecutors, public prosecutors, or remain outside their field of view altogether. Such violations are OIM in the absence of grounds enumerated in items 1-6 of part 2 of Article 7 of the Law on OIA; approval of the use of OIM by officials who are not authorised for this; faultily drawn acts and other material on the conduct of the OIM; illegal tapping, etc.

The Federal Law №40-FZ of April 3, 1995 (hereafter – the Law on the Federal Security Service) and the Law on OIA determine that telephone tapping shall be made only upon a court warrant. Bodies of the Federal Security Service (hereafter – FSS) shall have the right to submit requests for such actions.

Both the Law on the Federal Security Service and the Law on OIA describe conditions that must be met in order to conduct wiretaps. Such measures may be taken only on the basis of a judicial decision and subject to the availability of information:

- a) on indications of such wrongful act being prepared, being committed or having been committed for which a preliminary inquiry is obligatory;
- b) on persons preparing, committing or having committed a wrongful act for which a preliminary inquiry is obligatory;
- c) on events and acts that endanger the public, military, economic or environmental security of the Russian Federation (Article 8 of the Law on OIA).

²¹ Nazrullaevay, E., Baranovz, A., Yakovlev, A. (2013) *Criminal Persecution of Business in Russia’s Regions: Private Interests vs. “Stick” System* (draft version 2.1), p. 7

The law does not specify in what particular crimes the OIA and OIM can be used. The Article 8 of the law provides that, in urgent situations where a grave crime may be committed, as well as where the information corresponding to the above item 3 exists, investigation bodies may install telephone tapping without a court order, provided that the request will be submitted to the court within 24 hours. Within 48 hours after the start of wiretapping, the agency that does it must obtain the court warrant, which either allows the interception or orders it to be ceased.

Supervision over procedural activities of the organs of initial inquiry, pre-trial investigation and the judiciary: In accordance with Article 37 of the Code of Criminal Procedure, the prosecutor is the official authorised, within the limits of his/her competence, to exercise prosecution on behalf of the State in criminal proceedings as well as exercise oversight of the procedural activities of the bodies of initial inquiry and pre-trial investigation authorities. In addition to the prosecutorial supervision, the legislation of the Russian Federation also provides for the departmental control.

The prosecutorial supervision over the legality of actions of the bodies of inquiry and pre-trial investigation is understood as regulated activity by authorised prosecutors in the pre-trial stages of criminal proceedings aimed at ensuring legality in the criminal proceedings.

The prosecutorial supervision over compliance with the law in this case addresses two tasks. On the one hand, it serves as a means of ensuring the supremacy of the Constitution and protection of the rights and freedoms of citizens. On the other hand, he/she shall supervise proper implementation of the law and facilitate effective criminal prosecution because, in case of violations of the criminal procedure rules of investigation, the obtained information will have no value as evidence.

Supervising the legality of preliminary investigation and being the leader of the criminal proceedings in the pre-trial stage, the prosecutor must ensure a uniform approach to the organisation of the prosecutorial supervision of all the bodies of preliminary investigation and inquiry; immediately respond to identified violations of the law; ensure timeliness and legality of decisions of the investigator and the inquirer concerning the findings of verification of every crime report; take all possible measures to ensure the rule of law in the application of coercive measures; monitor the timeliness and correctness of investigatory actions; establish effective supervision over the legality and validity of termination of criminal cases and criminal prosecution, rescind the suspension of the preliminary investigation or termination of the criminal investigation if all possible means to gather evidence and identify the suspects have not been exhausted.

The legal basis of prosecutorial supervision over the authorities of pre-trial investigation and inquiry is found the Constitution of the Russian Federation, the Code of Criminal Procedure, the Federal Law No. 2202-1 of January 17, 1992 as well as by-laws issued by the Prosecutor General's Office, which include orders of the Prosecutor General's Office No, 136 of September 06, 2007, No. 137 of September 06, 2007, No. 189 of November 27, 2007, etc.

The subject of prosecutorial supervision over compliance with the law by bodies carrying out the inquiry and preliminary investigation is respect for: human rights and civil liberties in the course of conducting criminal proceedings; the legal procedure for handling submissions and reports of on-going, committed and planned crimes; the legality of the pre-trial investigation; laws in decision-making by bodies engaged in inquiry and preliminary investigation.

The law also establishes limits on the prosecutor's supervision.

- a) Supervision of the implementation of laws by preliminary investigation and inquiry bodies under item 31 of the Article 5 of the Code of Criminal Procedure may be carried out by the Prosecutor General and the prosecutors subordinate to him/her, their deputy and assistant prosecutors who participate in criminal proceedings. However, it is correct that, upon order of the supervising prosecutor, the assistant prosecutors have the right to participate in the verification of compliance with the requirements of the law of criminal procedure by bodies

of inquiry and preliminary investigation. However, they do not have the right to make final decisions since according to part 6 of Article 37 of the Code of Criminal Procedure the prosecutor's powers of supervision over the legality of preliminary investigation are vested in district or city prosecutors, their deputies, prosecutors identical to them and senior prosecutors.

- b) The prosecutorial supervision shall be carried out only within the framework of the Code of Criminal Procedure and the Law on the Public Prosecution and concern only procedural aspects. The prosecutor does not have the right to interfere with the organisational and managerial activity of bodies of preliminary investigation and inquiry.
- c) Orders of the supervising prosecutor are not always final and can be appealed to a higher prosecutor.

The powers of the prosecutor overseeing compliance with laws by bodies conducting inquiry and preliminary investigation are provided in the criminal procedure legislation of the Russian Federation and other federal laws. The Prosecutor General's guidance on issues of inquiries, which do not require legislative regulation, is binding. Moreover any actions of the investigator or the inquirer may be appealed in court²².

Finally, judicial review over preliminary investigation is regulated by Article 125 of the Code of Criminal Procedure which covers the decision of the inquirer, investigator, the head of an investigatory agency to institute a criminal case or to terminate a criminal case as well as other decisions and actions (omissions to act) of an inquirer, investigator and prosecutor which can inflict damage upon the constitutional rights and freedoms of the participants in criminal court proceedings or can interfere with the citizen's access to administration of justice. According to this provision the judge shall check the legality and substantiation of action (the lack of action) and decisions of the investigative bodies and prosecutor. Upon judicial review, the judge can leave the complaint without satisfaction or recognise the action (or lack of action) or decision of the corresponding official as illegal or unsubstantiated and rule on his liability to eliminate the committed violation.

In practice Courts are often declining jurisdiction under Article 125 alleging that the decision does not violate the applicant's constitutional rights even if violations of procedural rules have taken place. In most cases courts completely defer to investigative discretion on the basis of Article 38 of the Code of Criminal Procedure according to which "the investigator directs on his own the course of the investigation, takes decisions on the performance of investigative or procedural actions"²³.

Even in those cases where a court has ruled in favour of an accused or individual under investigation, execution of these decisions is fairly rare: according to statistics provided in 2012 by the vice president of the Supreme Court of Bashkortostan Republic, out of 602 judicial decisions adopted under Article 125, only 56 were executed.

According to the vice general prosecutor for the Privolozhsky Okrug, the failure of investigative authorities to open criminal investigations into allegations of abuse of force or threats against witnesses or accused in order to extract confessions and statements is quite widespread.²⁴ In such cases usually refusals to open a criminal investigation reach 98% of complaints. Often even the intervention of prosecutors is not sufficient to redress such violations and failures. In the Republic of Tatarstan, between 2011 and the beginning of 2012, 450 decisions were adopted by prosecutors

²² Prosecutorial review, as regulated under article 124 of the Russian CCP, does not however belong to the notion of effective remedies under the ECtHR case law: an appeal to a higher authority does not constitute an effective remedy (*Horvat v. Croatia*, § 47; *Hartman v. the Czech Republic*, § 66)

²³ E.Noskova (2008) *IMPROVING criminal procedure legislation, regulatory review complaint under PT. 125 of the Code [совершенствование уголовно-процессуального законодательства, регулирующего рассмотрение жалоб в порядке СТ. 125 УПК РФ]* available at <http://cyberleninka.ru/>; see also : A. Logodenko (2012) *Article 125 of the Code of Criminal Procedure [Статья 125 УПК РФ: практика применения]* available at <http://logodenko.ru/>

²⁴ For example in the ECtHR case *Dobryeva and others v. Russia*, concerning the failure of the investigative authorities to timely take certain steps such as order to preserve the evidence, delays in the opening of the investigation and their failure to keep the applicants informed of the relevant developments, the court found that the application of article 125 was ineffective.

declaring such refusals unlawful. However following review of the case only one investigation was reopened.²⁵ Among the possible reforms that may solve this situation, the vice general prosecutor for the Privolozhsky Okrug suggested returning the power to open criminal investigations to prosecutors rather than to investigators.

An official from the Department for execution of decisions of the ECtHR noted that in the Russian Criminal system there is no system of accountability concerning the obligation for investigative authorities to effectively execute judicial decisions under Article 125 of the Code of Criminal Procedure.²⁶

3.1.2 International standards

Principles such as those established in the European Convention on Human Rights are reviewed separately in relation to particular issues. However, here one should mention the **Council of Europe Recommendation Rec(2000)19 of the Committee of Ministers to member States on the role of public prosecution in the criminal justice system**²⁷, which states that prosecutors should ensure the application of the law where the breach of the law carries a criminal sanction, taking into account both the rights of the individual and the necessary effectiveness of the criminal justice system.

The recommendation identifies specific duties towards individuals. In the performance of their duties, public prosecutors should in particular, carry out their functions fairly, impartially and objectively; respect and seek to protect human rights, as laid down in the Convention for the Protection of Human Rights and Fundamental Freedoms; seek to ensure that the criminal justice system operates as expeditiously as possible.

In respect of relationship between public prosecutors and the executive and legislative powers, the recommendation provides that States should take appropriate measures to ensure that public prosecutors are able to perform their professional duties and responsibilities without unjustified interference or unjustified exposure to civil, penal or other liability. However, the public prosecution should account periodically and publicly for its activities as a whole and, in particular, the way in which its priorities were carried out.

In respect of the relationship between public prosecutors and court judges, the recommendation provides that public prosecutors must strictly respect the independence and the impartiality of judges; in particular they shall neither cast doubts on judicial decisions nor hinder their execution²⁸, save where exercising their rights of appeal or invoking some other declaratory procedure. Public prosecutors must be objective and fair during court proceedings. In particular, they should ensure that the court is provided with all relevant facts and legal arguments necessary for the fair administration of justice.²⁹

Pursuant to the recommendation, **training** is both a duty and a right for all public prosecutors, before their appointment as well as on a permanent basis. States should therefore take effective measures to

²⁵ Ibid.

²⁶ Ibid.

²⁷ *Rec(2000)19E 06 October 2000 on the role of public prosecution in the criminal justice system* available at www.coe.int/

²⁸ The failure to execute a court decision has been considered by the European Court of Human Rights as a major violation of the right of access to court. In this respect the Court stated that one of the fundamental aspects of the Rule of law is the principle of legal certainty (*Okyay and others v. Turkey*, Para 73) which requires, inter alia, that where the courts have finally determined an issue, their ruling should not be called into question (*Brumarescu v. Romania* Para 61).

²⁹ In the Judgment *Assanidze v. Georgia* the ECtHR held that the execution of a judgment given by any court must be regarded as an integral part of the trial for the purposes of Article 6 (*Assanidze v. Georgia* [GC], § 181). The guarantees afforded by Article 6 of the Convention would be illusory if a Contracting State's domestic legal or administrative system allowed a final, binding judicial decision to acquit to remain inoperative to the detriment of the person acquitted. Criminal proceedings form an entity and the protection afforded by Article 6 does not cease with the decision to acquit (*ibid.*, § 182). If the State administrative authorities could refuse or fail to comply with a judgment acquitting a defendant, or even delay in doing so, the Article 6 guarantees previously enjoyed by the defendant during the judicial phase of the proceedings would become partly illusory (*ibid.*, § 183).

ensure that public prosecutors have appropriate education and training, both before and after their appointment. Furthermore, states should take effective measures to provide for additional training on specific issues or in specific sectors, in the light of present-day conditions, taking into account in particular the types and the development of criminality, as well as international co-operation on criminal matters.

In order to respond better to developing forms of criminality, in particular organised crime, **specialisation** should be seen as a priority, in terms of the organisation of public prosecutors, as well as in terms of training and in terms of careers. Recourse to teams of specialists, including multi-disciplinary teams, designed to assist public prosecutors in carrying out their functions should also be developed.

With respect to **the organisation and the internal operation of the Public Prosecution**, in particular the assignment and re-assignment of cases, this should meet requirements of impartiality and independence and maximize the proper operation of the criminal justice system, in particular the level of legal qualification and specialisation devoted to each matter.

In the explanatory memorandum to the “Report on the role of the public prosecutor in a democratic society governed by the rule of law” of the 24th of April 2003, the rapporteur of the CoE PA’s Committee on legal affairs and human rights, held that there are **strong arguments in favour of excluding the police from any role in deciding upon or pursuing prosecutions**: most obviously that police officers, having the most immediate role in investigating offences and identifying and questioning suspects, may be less objective in determining whether to charge an individual than a more distant prosecutor.³⁰

The report also expressed a **negative view of those national legislation whereby prosecutors are charged both with the protection of human rights and are involved in proceedings whose essential purpose is to interfere with that person’s rights**: such a system was considered to raise questions about the objectivity and impartiality of the body in question when requested to act in protection of individual rights. Furthermore the individual concerned may consequently be reluctant to approach that body for the protection to which they are entitled. Both considerations have potentially serious consequences for the State’s discharge of its obligation to secure to everyone within its jurisdiction, without discrimination, the rights set out under the ECHR.

3.1.3 Remedies against misuse in Council of Europe member states

The overview below highlights the existence of a plurality of mechanisms aimed at ensuring that the protection of defendants’ rights in the context of a criminal investigation is not undermined by excessive deference to prosecutorial discretion. Criteria have been developed in order to assess whether there are sufficient grounds to open a criminal investigation against individuals (United Kingdom). Specialised judges have been charged with either the carrying out of the investigation (France) or with the supervision over the investigative stage to the extent that the investigation is regarded as a judicially supervised inquiry into an offence rather than the gathering of evidence to support the prosecution of the accused (Italy). Judges have been charged with the taking of certain evidence such as statements under oath or with the review of the evidence in order to decide whether there are sufficient grounds for an indictment (Italy). Depending on the gravity of the violation and on the impact that such violations may have on a defendant’s right to fair trial or on the administration of justice such remedies span from the introduction of a regime of nullities of investigative acts and decisions, to the inadmissibility of evidence, to the stay of proceedings by a court (France, the Netherlands, Belgium, United Kingdom). Stronger court supervision over the investigative stage is supplemented by the existence of a detailed regime of disciplinary, criminal and civil responsibility.

³⁰ In Continental law countries, the police have never prosecutorial roles. The exception is Norway where the police have prosecutorial functions in respect of minor cases.

3.1.3.1 Establishing whether there are sufficient grounds to open a criminal investigation:

The United Kingdom

In the United Kingdom, guidance to prosecutors on the general principles to be applied when making decisions about prosecutions is provided by the Code for Crown Prosecutors. The goal of the Code for Crown Prosecutors is to make sure that the right person is prosecuted for the right offence and to bring offenders to justice wherever possible.

Pursuant to the Threshold Test set up by the Code, prosecutors should swiftly stop cases which do not meet certain evidentiary requirements and which cannot be strengthened by further investigation, or where the public interest clearly does not require a prosecution.

In most cases, prosecutors should only decide whether to prosecute after the investigation has been completed and after all the available evidence has been reviewed. However there will be cases where it is clear, prior to the collection and consideration of all the likely evidence, that the public interest does not require a prosecution.

Prosecutors must be satisfied that there is sufficient evidence to provide a realistic prospect of conviction against each suspect on each charge. They must consider what the defence case may be, and how it is likely to affect the prospects of conviction. A case, which does not pass the evidential stage, must not proceed, no matter how serious or sensitive it may be.

The finding that there is a realistic prospect of conviction is based on the prosecutor's objective assessment of the evidence, including the impact of any defence and any other information that the suspect has put forward or on which he or she might rely. It means that an objective, impartial and reasonable jury or bench of magistrates or judge hearing a case alone, properly directed and acting in accordance with the law, is more likely than not to convict the defendant of the charge alleged. This is a different test from the one that the criminal courts themselves must apply. A court may only convict if it is sure that the defendant is guilty.

According to the code, prosecutors should consider whether there is any question over the admissibility of certain evidence. In doing so, prosecutors should assess: the likelihood of that evidence being held as inadmissible by the court; the importance of that evidence in relation to the evidence as a whole, whether the evidence collected is reliable and whether it is credible.

In every case where there is sufficient evidence to justify a prosecution, prosecutors must go on to consider whether a prosecution is required in the public interest.

A prosecution will usually take place unless the prosecutor is satisfied that there are public interest factors tending against prosecution, which outweigh those tending in favour. In some cases the prosecutor may be satisfied that the public interest can be properly served by offering the offender the opportunity to have the matter dealt with by an out-of-court disposal rather than bringing a prosecution. Usually a prosecution will take place when the offence is very serious; the level of culpability of the suspect and the vulnerability of the victim is high. This includes where a position of trust or authority exists between the suspect and victim.

Normally, if the Crown Prosecution Service (CPS) tells a suspect or defendant that there will not be a prosecution, or that the prosecution has been stopped, the case will not start again.

“The CPS will review all police charged cases prior to the first hearing in accordance with their duty under the Code for Crown Prosecutors. Where it appears that the police have charged a case not permitted by this Guidance, the reviewing prosecutor must consider whether the evidence and material available at that time fully meets [the evidentiary test].

Where it does, the prosecutor will continue with the prosecution and record the reason with the case review. Where it does not meet the appropriate Test, the prosecutor should immediately enquire if there is any other material available which has not been provided which may allow the case to continue. Where that is not the case, the prosecution should be discontinued pending the gathering of further evidence and the referral of the case to a prosecutor to make a charging decision.”³¹

In case an offence is charged by the police in circumstances not permitted by the Guidance for Prosecutors, “the decision may be challenged at court and could be subject to judicial review proceedings. It may give rise to liability under the civil law, especially if a suspect has been detained in custody”.³²

France: opening of an investigation and the power of the *procureur* to pursue alternatives to prosecution

The power to open an investigation in France belongs exclusively to the *procureur*³³. In addition the *procureur* has, pursuant to Articles 41-1 and 41-2 of the Code of Criminal Procedure, the power to implement alternatives to a prosecution such as: bringing to the attention of the offender the duties imposed by law; requiring the offender to regularise his situation under any law or regulation; requiring the offender to make good the damage caused by the offence; and, with the consent of the parties, arranging mediation between the offender and the victim.

Where the victim is identified, and unless the offender establishes that the damage has been made good, the district prosecutor must propose to the offender that he make good the damage caused by his offence within a period, which may not exceed six months. The *procureur*'s proposal for conditional suspension may be brought to the knowledge of the offender through a judicial police officer. Here it takes the form of written decision signed by the *procureur*, which specifies the nature and quantum of the measures proposed and which is endorsed on the file.

As of 2004 the accused has 10 days during which to consider the *procureur*'s proposal. This is intended to provide lawyers with an opportunity to advise their clients as to the offer and, if possible, to negotiate the terms of the case's outcome.

A conditional suspension may be proposed in any public centre for legal advice. The person to whom conditional suspension is proposed is informed that an advocate may assist him before giving his consent to the *procureur*'s proposal. This consent is recorded in an official record and a copy is given to the person concerned.

Where the offender consents to the measures proposed, the *procureur* seizes the President of the district court by way of a petition seeking the approval of the conditional suspension. The *procureur* then informs the offender and, where necessary, the victim.

The President of the court may proceed to hear the offender and the victim, assisted, where necessary, by their advocates. Where the judge makes an order approving the conditional suspension, the measures decided are put into effect; if not, the proposal becomes void.

Italy: pursuing alternatives to criminal prosecution and detention for economic crimes

³¹ The Crown Prosecution Service (2013), *The Director's Guidance On Charging* - fifth edition (revised arrangements) available at www.cps.gov.uk/

³² Ibid.

³³ In France as in the majority of the other civil law countries the prosecutor has considerable power of supervision, direction and coordination over investigative authorities: The French judicial police is directed by the public prosecutor, supervised by the prosecutor general and controlled by the investigating chamber (Sect. 13 of the Code of Criminal Procedure: hereafter CCP). The public prosecutor controls the judicial police in three different ways:

- supervising and checking investigations;
- being in charge in the co-ordination of the services involved; and
- choose the service that will be responsible for the inquiries.

In the field of economic crimes involving corporate entities the Italian legislator, like many others, has introduced a detailed sanctioning regime based on a system of pecuniary sanctions and bans that are deemed as more appropriate than criminal prosecution and detention.

According to decree 231/2001 on corporate liability³⁴, a binary system of sanctions is foreseen. While pecuniary fines are always administered upon finding of violations, other dissuasive measures are applied only in cases of grave violations. Pecuniary sanctions are established in a measure that is between a given minimum and a maximum amount and must take in consideration the amount of proceeds of crime as well as the patrimonial and financial situation of the company. The amount of the fine is reduced in case of non-particularly grave violations and in cases where the company has adopted measures to compensate the harm done or to restore the situation (*restitutio in integrum*).

Besides this sanctions are applied on the basis of a precise regime: Temporary closure of a plant or factory, suspension or revocation of authorisations or licenses which played a role in allowing the commission of a crime, temporary prohibition to carry out a certain activity, prohibition (even temporary) to contract with public authorities, exclusions from state benefits, funding and revocation of those that have already been granted, prohibition (even temporary) to advertise goods or services.

Precondition for the application of these sanctions is that the corporate entity has obtained a substantial amount of benefits (proceeds of crime) from the commission of the crime and the crime has been committed by individuals placed in upper managerial positions or by individuals operating under others' control and the violation has been possible due to the lack of adequate organisational measures. The other precondition is that the corporate entity has already been condemned for the commission of corporate crimes in the past. The rationale behind this provision is that pecuniary sanctions must have proven insufficient to deter the company from the commission of crimes (especially when pecuniary sanctions are limited in comparison to the proceeds of crime or other benefits obtained as a result of the commission of the crime) and the company showed a tendency towards the involvement in criminal activities. Some of these sanctions cannot be applied in case the company has adopted measure to compensate the damages caused. Temporary sanctions can be applied for a period between 3 months and two years.

Another important limitation in the application of these sanctions is that they must be applied only to those activities connected to the commission of the crime. The application of sanctions to the whole corporate entity is applicable only if the crime is expression of a generalised inclination of the organisation towards the commission of crimes (when the development of criminal practices involves the higher echelons of the organisation).

The application of these sanctions also presupposes that the competent judge assess their ability to deter the re-commission of the crimes. The prohibition to carry out a given activity can only be applied if other measures have proven insufficient to prevent the re-commission of crimes. The same goes for any dissuasive sanctions that entail the interference in the carrying out of a company's activity.

In order to ensure consistency in the application of the law it is also foreseen that, once the conditions for their application have taken place, the judge is obliged to apply them. There is hence no leeway for the discretion of the judge in deciding whether to apply these sanctions or not. Finally in order to avoid that unfair harm is caused to third parties, such as employees who would lose their job following suspension or interdiction of an activity; it is also possible to appoint an administrator who will manage the company in substitution of the affected individual.

³⁴ Law 231 of 8 June 2001, [*Decreto Legislativo 8 giugno 2001, n. 231*, "Disciplina della responsabilita' amministrativa delle persone giuridiche, delle societa' e delle associazioni anche prive di personalita' giuridica, a norma dell'articolo 11 della legge 29 settembre 2000] available at www.camera.it/

3.1.3.2 *Models of judicial control over the criminal investigation: France and Italy*

In Continental law countries there are essentially two models of judicial involvement in the criminal investigation. The French model is based on the inquisitorial role of the judge, which is actively involved in the investigation of the facts. This model was predominant in Europe until recent years, but has been progressively been abandoned: in Germany this model was abandoned in 1975, in Switzerland in 2011, in 1989 in Italy and more recently, it appears that Spain will also adopt the new model based on a judge for the preliminary investigation (rather than the investigating judge). Such model sees the judge focusing on the issue of the law and procedure and act as a referee between defence and prosecutor.

In any case, both models are characterised by an increased scrutiny of the judges over the investigative stage, which may extend beyond the review of deprivation of liberty³⁵ or asset freezing requests and cover the taking of evidence or the course of the investigation.

The French investigating magistrate

The French legal system is characterised by a state centred conception of justice whereby the judge maintains a central role during the investigation. As is usual within the inquisitorial tradition, the judge is also chiefly responsible for the protection of defence rights at the investigation stage.

Investigations are carried out by the police under the supervision of the *procureur*, or the *juge d'instruction*, and the function of the trial court is not only to pass judgment on the evidence presented by the parties, but to conduct its own inquiries into the case in order to satisfy itself of the guilt or innocence of the accused.

Although the trial represents an important (and publicly accountable) hearing of the case, historically, much emphasis had been placed on the pre-trial phase. The investigation is regarded as a judicially supervised inquiry into the offence and the evidence surrounding it, rather than the gathering of evidence to support the prosecution of the accused.

Any issues concerning the deprivation of liberty of the person under investigation is decided by a specialised court: the *juge des libertés et de la détention*. Investigations are, in the majority of cases, led by the *procureur* (who as a magistrate is also a member of the judiciary). As a magistrate the *procureur* is more neutral, and has a wider ranging role, than a simple prosecutor, and is in charge both of supervising the investigation and of overseeing the detention of suspects in police custody, including the protection of their due process rights.

Although *procureurs* are, as magistrates, subject to the same governing body as other judges (*le conseil supérieur de la magistrature*) they are also in a subordinate relationship to the Minister of Justice who has, pursuant to Article 36 of the Code of Criminal Procedure (CCP), the power to issue instructions in individual cases. This power has raised controversy on several occasions due to the dangers that it poses for the independence of the magistrates.

Following several controversial cases in the 1980s and '90s where the Ministry of Justice actively issued instructions in individual cases concerning politicians and business people, new regulations were introduced requiring, for example, that instructions be given in written form. The practice of using less formal communications between the *procureurs* and the Ministry of Justice, however, remains and such communications are usually treated as "instructions". In the 1990s such instructions

³⁵ The ECtHR case law provides substantial guidance on the standards for judicial review of pre-trial detention, irrespective of the specific qualification of the competent judge: in the case of *Jėčius v. Lithuania* where the Court stated that Article 5 (4) entitles the accused to a review bearing upon the procedural and substantive condition which are essential for the "lawfulness", in Convention terms, of their deprivation of liberty. This means that the competent court has to examine not only the compliance with the procedural requirements of domestic law but also the reasonableness of the suspicion underpinning the arrest and the legitimacy of the purpose pursued by the arrest and the ensuing detention.

were used occasionally to delay investigations into sensitive cases (often involving politicians) in order to allow ministers to resign or to block politically sensitive cases even though, pursuant to Article 36 of the CCP, orders to discontinue a case are excluded from the Ministry's powers.

Ultimately, following the UNCAC³⁶ and OECD³⁷ recommendations calling for additional guarantees to safeguard the impartiality of prosecutors, the Criminal Procedure Code was amended in July 2013 to clearly state that the Minister of Justice cannot give instructions to prosecutors in individual cases.

Investigations led by the *juge d'instruction* have traditionally been quite different. Some *juge d'instruction* have regularly engaged in controversial and high profile investigations, and political and administrative officials have been increasingly investigated and held criminally responsible for acts of negligence. Politicians and powerful business people have also come under scrutiny in a series of corruption cases that have implicated players from both sides of the political spectrum. Before 1988 and 1990, when laws were passed to regulate the funding of political parties, it was discovered in an investigation led by *juges d'instruction* that three-quarters of all business funding at election came from firms liable to bid for contracts with local authorities run by party politicians.

The media has also played an important part in preventing these investigations from being side-lined by *procureurs* constrained to act on the instructions of the Ministry of Justice. Despite the apparent secrecy of the instruction, key evidence has been leaked to the press and a number of *juges d'instruction* have adopted a high media profile. Many of them have acknowledged the valuable role of the media in acting as a "lever of change". More recently, however, it has come to be believed that such use of the media is no longer necessary as the judges have managed to strengthen their independence and so it was considered better to move away from a highly mediated and personalised image of justice to one which focuses on the case and evidence.

It should, however, be noted that, as the *juges d'instruction* are in charge of only a small percentage of investigations the impact of the *juge d'instruction* on the fight against corruption remains limited.

Functions of the juge d'instruction

Although only a small percentage of cases are dealt with in this way the *instruction* represents the paradigm model of investigation within the French inquisitorial model. The *juge d'instruction* has responsibility for the most serious and complex cases - certain investigative measures such as telephone taps can only be authorised by a *juge d'instruction*. They also become involved where an investigation cannot be carried out within the strict terms of the *GAV* (*garde à vue*, custody) or when the *procureur* wants a suspect to be placed in custody while the investigation continues.

The opening of "information" by a *procureur* in order that a *juge d'instruction* can investigate is obligatory for the most serious offences, crimes, and discretionary for lesser offences (Article 79 CCP). It may also be initiated for petty offences if it is requested by the *procureur*.

The *juge d'instruction* may only investigate in accordance with a submission made by the *procureur*. This means that even if in the course of an investigation further crimes are discovered, the investigation of those crimes requires the authorisation of the *procureur*.

The *juge d'instruction* undertakes, in accordance with the law, to take any investigative step he deems necessary for the discovery of the truth. He seeks out evidence of innocence as well as guilt (Article 81 CCP).

Where it is impossible for the *juge d'instruction* to undertake in person all aspects of the investigative, he may authorise judicial police officers to perform the necessary investigation and then report back to him. The *juge d'instruction* is required to check all information thus collected. Acts that cannot be

³⁶ UNCAC (2011), *France Implementation Review*, [*Résumé analytique : rapport de la France*], Vienna, p. 5 available in French only at www.unodc.org/

³⁷ OECD (2012), *Phase 3 report on implementing the OECD Anti-Corruption Convention on France*, p. 5

delegated but must be performed by the *juge d'instruction* personally include the inquiry into the veracity of interview records and the questioning of the person under investigation.

Individuals under investigations in cases subjected to the jurisdiction of the *juge d'instruction* also enjoy stronger defence rights.

The nature of the questioning by the *juge d'instruction* is very different from the interrogations that take place during the GAV at the police station: while the latter tend to be more hostile and coercive, questioning by the *juge d'instruction* takes place in the *Palais de Justice*, and care is taken to ensure the accuracy of the interview record as the accused is given MEE (*Mis en examen*) an opportunity to correct any errors before the document is printed off and signed.

In this way the investigation characterises the inquisitorial roots of French criminal procedure, where issues are selected and debated not by the prosecution and defence at trial but by a judge during a pre-trial investigation.

The dual function of the *juge d'instruction* is so internalised that it has become widely accepted and positively viewed while the defence role of lawyers tend to be marginalised. For the *juge d'instruction*, as for the *procureur*, the defence serves as a legitimating function, acting as a demonstration and as a guarantee of the fairness of the procedure.

On the other hand, following important judgments of the ECtHR, the pre-trial role of the defence lawyer has evolved and has been strengthened. Such defence rights are, however, stronger in the context of the investigation carried out by the *juge d'instruction* compared to those carried by the *procureurs*.

The jurisprudence of the European court recognises that the trial cannot be treated as a discrete phase in the criminal process, unaffected by the pre-trial investigation, and the denial of defence rights at the investigation stage is likely to prejudice the preparation of the defence case and so the fairness of the trial. For those investigated under the supervision of the *procureur* such defence rights have been interpreted in the narrowest possible way (for example where the suspect has the right to remain silent but is not informed of this right).

Defence lawyers in cases investigated by the police under the supervision of the *procureur* could previously only meet suspects for 30 minutes and were denied access to the case dossier. Defence lawyers have now gained better and earlier access to the dossier and have been granted a period of five working days before any judicial questioning of their clients can be made.

During the instruction the role of the defence lawyer is considerably stronger due to his ability to influence the construction and content of the dossier which forms the evidential centrepiece of the trial. While his role does not challenge the basic principle of judicial supervision, as the lawyer only engages with the investigation through *the juge d'instruction*, he also acts as an auxiliary to the *juge* that he may scrutinize the results of the investigation, challenge irregularities in the procedure, request that certain investigations be carried out and be present during the interviews of his client and other witnesses.

The *juge d'instruction* can automatically, or at the demand of the court or a civil party, carry out, in accordance with the law, any act permitting him to evaluate the nature and the importance of the prejudice suffered by the victim, or to obtain information about the latter's personality (Article 81-1 CCP).

The *juge d'instruction* is in charge of interrogations, confrontations and hearings. The *procureur*, the advocates acting for the parties and any assisted witness, may ask questions or make brief observations.

Lawyers will usually follow a collaborative approach with the *juge d'instruction* rather than directly challenging his decisions, and often the most successful defence approach is to combine a subtle process of manoeuvring with informal requests.

Following the Outreau case (2004) further measures have been adopted in order to ensure stronger protection to investigated individuals. In the Outreau case, seven out of seventeen defendants were acquitted of charges relating to child sexual abuse. Following the acquittal one of the defendants told the court how the *juge d'instruction* had not been interested in her account and become angry and threatening in the face of her denials. Six of the seven individuals acquitted were kept in custody for three years on the basis of accusations that were withdrawn at trial. As the trial proceeded it was felt that the *juge d'instruction*, who was young and inexperienced, had constructed the case against the accused. As a result, immediately following the acquittals the Minister of Justice announced the establishment of a working party to look at the process of *instruction*. A report was published in 2005 and recommended the appointment of two *juges d'instruction* in complex and sensitive cases in order that the workload could be shared and theories and ideas cross-checked, thus avoiding the tunnel vision of case construction. This reform, although aimed at improving the protection of defines rights, showed once again how the role of the defence lawyer is not considered as key in the investigation of crime.

Italy

In Italy the protection of defence rights at the stage of preliminary investigations is ensured through a plurality of mechanisms and principles. Special judges (the Judge for preliminary investigation and the preliminary hearing judge) have been created in order to review acts and decisions of prosecutors at the investigative stage and to decide whether an individual should be committed to trial. Individuals under investigation have also increased rights to participation in the course of criminal investigation as, in certain circumstances they can request that evidence is gathered with their participation and with participation of the judge.

The judge for preliminary investigation

Although the investigation is carried out by prosecutors and the police, the law provides that any time in the course of the investigation there is a need to carry out specific acts impinging on the liberties of the person under investigation or acts that may have an impact on his fate, the relevant measures must be adopted by the specific judge: the judge for preliminary investigation (*Giudice delle indagini preliminari* – GIP).

The judge for preliminary investigations is also responsible for applying measures restricting the personal freedom of the person under investigation, such as pre-trial detention or house arrest, as well as asset freezing orders.

The task of the judge for preliminary investigation is to ensure that the work being carried out by the public prosecutors is in compliance with the law and respects the rights of the person under investigation.

The judge for preliminary investigations is responsible for applying measures restricting the personal freedom of the person under investigation, such as pre-trial detention or house arrest, as well as asset freezing orders.

In addition, at the request of the parties, the judge for preliminary investigations has to decide on whether a special enquiry procedure should be admitted for the recording of evidence during the pre-trial phase (*incidente probatorio*) and presides over the adversarial procedure for the taking of this evidence. The judge for preliminary investigations also rules on any requests for the case to be dismissed.

The decisions of the investigative judge are subject to appeal as the defendant or the prosecutor can appeal against the order of the Judge before the Court of Liberty (*Tribunale della Libertà*). This court

can uphold, modify or quash the Judge's order, reviewing all the circumstantial evidence (which is enough for an arrest warrant or a precautionary measure, but not necessarily to sentence). Its decision can be appealed before the Supreme Court (*Corte di Cassazione*), which cannot rule on the merits, but only on correct procedure and correct interpretation of the law.

The preliminary investigation phase ends when the public prosecutor decides whether or not to officially charge the person under investigation.

If the public prosecutor believes that there is no evidence to show that the person under investigation has committed the crime (or that the evidence is insufficient to sustain the accusation in court) or that the act does not constitute an offence, he asks the judge for preliminary investigations to close the case. The judge can either agree to this request or order the public prosecutor to carry out further investigations. If, after these further investigations, the public prosecutor still believes that there are no grounds for the case to go to court, s/he can nevertheless be ordered by the judge for preliminary investigations to issue an indictment. It should also be noted that if a case is closed, the victim of the crime can appeal against this decision before the judge for preliminary investigations.

In the case an investigation has been closed by the prosecutor, the prosecutor will not be able to adopt any further measure in respect of the same crime unless he asks and obtains authorisation from the judge for preliminary investigation to reopen the case. Without such authorisation any measures adopted by the prosecutor will be inadmissible at trial and the prosecutor will lose the right to prosecute the crime in the future.

The jurisdiction of the judge for preliminary investigation has been described in literature as a half-jurisdiction since his initiative is conditional on the submission of requests on the part of the prosecutor, the victim and the person under investigation. He can rule on a limited set of issues specified in the Code of Criminal Proceedings and has not *ex officio* power to gather evidence or carry out other investigative measures while his function is focused on the protection of defence rights. However it should be noted that following decisions of the Constitutional Court, this judge have been given a more active role as regards the collecting of evidence.

The Judge for the preliminary hearing

When the preliminary investigation is over, if the prosecutor deems that he can make his case, he summons the defendant to appear before the Judge of the Preliminary Hearing (*Giudice per l'Udienza Preliminare*).

Before him, the prosecutor presents all the evidence he has gathered so far; the defendant can make his case and try to prove that the conditions required for a trial and a guilty verdict are not satisfied.

If the judge of the preliminary hearing thinks that the evidence gathered so far is enough to warrant a conviction, he issues the order of indictment before the Court.

The judge for the preliminary hearing has the power to review the legitimacy and the merits of the charges brought by the prosecutor. While the judge for preliminary investigation has no control over the criminal case file which remains in the hands of the prosecutor, once a prosecutor requests a preliminary hearing he has to transfer the case file to the judge for preliminary hearing. After this date, the prosecutor is obliged to notify both the judge and the defendant of any further investigative measure he undertakes.

If the judge of the preliminary hearing considers that, based on the existing evidence, it cannot take any decision to commit the accused to trial due to the incomplete character of the investigations, he can issue an order to the prosecutor where he indicates which further investigative measure is needed and sets a deadline for its completion and the date the new preliminary hearing. Following this hearing, the judge may decide to commit the accused to trial, dismiss the charges, or issue a new order for the further conduct of investigative measures. In the latter case if the judge still is unable to

decide based on the evidence at its disposal, he can order *ex officio* the taking of evidence which decisiveness is essential for the adoption of a decision of no case to answer. Otherwise, the preliminary hearing judge grants the request for committal to trial and issues a decree ordering the beginning of the trial.

In order to ensure the impartiality of the different types of judges the law has introduced a regime of incompatibilities between the function of judge for preliminary investigation, judge for preliminary hearing and trial judge.

3.1.3.3 Remedies against violations and irregularities in the course of the investigation: nullities, invalidities of procedural acts and exclusionary rules

France

While it is true that the procedure under the *juge d'instruction* allows for stronger protection of defence rights, violations of defence rights may still take place and have been addressed through a variety of provisions:

The parties can ask for the substitution of a *juge d'instruction* and in order to ensure his impartiality the *juge d'instruction* may not take part in the trial of any criminal cases he dealt with in his capacity as a *juge d'instruction*, under penalty of nullity.

The non-observance of the formalities laid down for subpoenas, summonses, committal orders, arrest warrants and warrants to search for persons can lead to disciplinary sanctions against the *juge d'instruction*, the *juge des libertés et de la détention* or the *procureur*.

In the course of the investigation the investigating chamber may, in any matter, be referred for annulment, a procedural instrument or procedural document by the *juge d'instruction*, by the *procureur*, by the parties or by an assisted witness (Article 170 CCP).

There is a nullity when the breach of an essential formality provided for by a provision of the present Code or by any other rule of criminal procedure has harmed the interests of the party it concerns (Article 171 CCP). The party in respect of whom an essential formality has been broken may waive the breach and thus regularise the proceedings. Such a waiver must be expressly stated. It may only be made in the presence of the advocate or where the latter has been summoned in due form (Article 172 CCP).

Procedure for annulment of a procedural act

If the *juge d'instruction* believes that a procedural step or instrument is tainted by nullity, he can refer it to the investigating chamber for annulment, after having heard the opinion of the *procureur* and having informed the parties.

If the *procureur* considers a nullity has been committed, he orders the *juge d'instruction* to send him the case file in order to transmit it to the investigating chamber, files an annulment application with this chamber and informs the parties thereof.

If one of the parties, or an assisted witness, considers that a nullity has been committed, he refers the case to the investigating chamber by filing a reasoned application of which he sends a copy to the *juge d'instruction* who transmits the case file to the president of the investigating chamber. The application must, under penalty of inadmissibility, be filed as a statement with the court office of the investigating chamber. It is recorded and dated by the clerk who signs it with the applicant or his advocate. If the applicant is unable to sign, the clerk to that effect makes an entry. Where the applicant or his lawyer does not reside within the area of jurisdiction of the competent court, the statement made to the court office may be made by recorded delivery letter with a request for acknowledgement of receipt. Where the person under judicial examination is detained, the application may also be made through a statement filed with the prison governor. This statement is recorded and dated by the prison governor

who signs it with the applicant. If the latter is unable to sign, the prison governor to that effect makes an entry. This document is immediately sent in its original form or as a copy, by any means available, to the court office of the investigating chamber.

Within eight days of receipt of the case file by the court office of the investigating chamber, the president may, by an order that cannot be appealed, rule that the application is inadmissible pursuant to the present article, third or fourth paragraph, Article 173-1, Articles 174 first paragraph, or 175 second paragraph; he may also rule that an application is inadmissible if it is made without reasons given. If he finds the application inadmissible, the president of the investigating chamber orders the case file of the investigation to be returned to the *juge d'instruction*; in the other cases, he transmits it to the public prosecutor who proceeds as stated under Articles 194 onwards.

The Netherlands

The Dutch Code of Criminal Procedure contains a provision that allows for the exclusion of illegally gathered evidence, whether in violation of statutory rules or constitutional provisions. The Dutch law says that if a violation cannot be remedied, then the judge, will take into account the importance of the interest protected by the procedural rule, the seriousness of the violation and the harm it caused to the rights of the defendants. If the judge finds a remedy is warranted, he has several options: the most severe it to dismiss the entire criminal action (for the most serious nullities), or he can prevent the use of evidence at trial or he can reduce the sentence due to the violation but allow the evidence to be used at trial (Article 359a of the CCP).³⁸

Article 359a mentions the breach of procedural rules during the preliminary investigation. No distinction is made between different types of rules as they can be both rules for the protection of fundamental rights as well as other procedural rules.

Besides this, Article 359 CCP only applies to irremediable breaches of procedural rules. If they can be still remedied, for example by repeating an act, it should be possible to do so without attaching a legal consequence to these rules. The Dutch Supreme Court stated that in order to decide whether a legal consequence will stem from a breach of procedural rules and what this consequence would be, the judge must take into account the interest that the breached rule serves, the gravity of the breach and the harm caused by the breach. In certain circumstances, the good faith of the investigating officers who caused the breach of procedural rules can play a part³⁹.

In the case of grave breaches, the normal consequence will be barring prosecution, while minor violations will only entail a reduction in sentence or a mere determination of illegality.

The most serious sanction, which is barring prosecution, is adopted if investigators or prosecutors have seriously breached principles of fair trial either on purpose or with gross disregard for the interest of the accused⁴⁰. To date this sanction has been imposed mainly in cases where the possibilities of judicial monitoring of the gathering of evidence were deliberately thwarted.⁴¹ Another

³⁸ Article 359 a reads as follows: If procedural rules prove to have been breached during the preliminary investigation, which breach can no longer be remedied, and the legal consequences of the breach are not apparent from statutory law, the court may rule that: a) the severity of the punishment will be decreased in proportion to the gravity of the breach if the harm caused by the breach can be compensated in this way, b) the results of the investigation obtained though the breach may not contribute to the evidence of the offence charged, c) the public prosecution service will be carried from prosecuting if the breach makes it impossible to hear the case in compliance with the principles of due process.

In applying the first subsection, the court must take into account the interest that the breached rule serves, the gravity of the breach and the harm it causes. The judgment must contain the decisions referred to in the first subsection. These must be reasoned.

³⁹ HR June 3, 2001, Dutch law reports 2001, 536 and HR March 26, 2002, Dutch Law reports 2002, 343

⁴⁰ HR December 19, 1995, Dutch Law reports 1996, 249 Annotated by Schalken

⁴¹ HR February 4, 1997, Dutch Law reports, 308, annotated by Schalken and HR September 8, 1998, Dutch Law reports 1998, 879 annotated by Schalken

instance is when an unacceptable agreement is made with a witness for the prosecution that, in exchange of acting as such, any prison sentence imposed would not be enforced⁴².

In the case of grave breaches, the normal consequence will be a staying of prosecution, while minor violations will only entail a reduction in sentence or a mere determination of illegality⁴³. Exclusion of evidence will take place when there will be a causal link between the violation and the evidence gathered such as when premises are searched in violation of procedural rules: in this case the evidence will be considered inadmissible⁴⁴.

Sentence reduction is applied when the suspect has actually been harmed by the breach, the harm was due to the breach, the harm is suitable for compensation by sentence reduction and the sentence reduction is justified in light of the importance of the breached rule and the gravity of the breach. Such measure may be adopted in case of searches that observe the main but not all legal requirements⁴⁵ or when the unlawful action does not result in the gathering of evidence and evidence cannot be excluded for that reason. A typical example is an arrest which is lawful in itself but that is accompanied by unnecessary force⁴⁶.

The Supreme Court also stated that not all violations of procedural rules will entail the consequences indicated in Article 359 CCP as the rationale behind this norm is that a breach does not necessarily result in some advantage for the accused. So, in these cases a finding of violation will be enough⁴⁷.

Italy

The Code of Criminal Proceedings has introduced a set of nullities and invalidities for acts carried out in violation of the law⁴⁸. The types of invalidities and nullities indicated by the legislator are exhaustive and other violations of the law not expressly listed will only lead to the irregularity of the act (which may lead to the imposition of a disciplinary sanction on the author but have no consequences for the proceedings).

The types of invalidity regulated by the Code of Criminal Proceedings include: inadmissibility, prescription, nullity and exclusion of evidence. The inadmissibility of certain acts prevents the court from reviewing the merits of the request made by the party.

Depending on the importance of the underlying interest or right concerned, nullities are divided into:

- Absolute Nullities;
- Intermediate nullities;
- Relative nullities.

The nullity of an act will affect any subsequent act.

Absolute nullities are imposed for the most serious violations which are deemed as detrimental to the fundamental values underscoring criminal proceedings (for example, capacity and number of judges, omitted notification to the accused, the absence of the legal representative when it is mandatory).

Absolute nullities cannot be remedied (except in the case of a final judgment intervened) and can be declared by the judge (even *ex officio*) at any stage of the proceedings.

⁴² HR June 1, 1999, Dutch Law reports 1999, 567, annotated by Schalken and HR June 8, 1999, Dutch law reports 1999, 773, annotated by Reijntjes

⁴³ Matthias J. Borgers and Lonneke Stevens, *The Netherlands: statutory balancing and choice of remedies in Exclusionary Rules in Comparative law* ed by Stephen Thaman, Springer Publishing 2013

⁴⁴ Ibid.

⁴⁵ HR July 2, 2002, Dutch law reports 2002, 624

⁴⁶ HR December 21, 2004, Dutch Law reports 2005, 172, annotated by JR

⁴⁷ HR January 27, 2009, Dutch law reports 2009, 86 (retrial)

⁴⁸ Article 179-181 of the Italian CCP

Intermediate nullities may be declared ex officio by the court but can still be remedied until the adoption of the judicial decision in the merits of the case. Such nullities concern for example instances when the victim has not been notified and has been unable to participate in the proceedings.

Relative nullities consist of minor flaws affecting the criminal proceedings (although they are more serious than mere irregularities) and by large can be remedied. These types of invalidities must be listed in specific provisions. They cannot be declared ex officio by the judge as a petition by the interested party is necessary for this purpose.

Other sanctions for violation of laws in the course of criminal proceedings are the prescription, which entails that an act cannot be carried out once a given term or deadline has passed and exclusionary rules that lead to the inadmissibility (un-usability) of evidence unlawfully gathered.

Among the various types of un-usability are:

- absolute un-usability;
- relative un-usability.

Absolute un-usability entail that at no point a judge may use the evidence gathered in violation of legal provisions. In the case of relative un-usability the evidence will be inadmissible only in respect of certain individuals or in respect of certain proceedings (an example of the latter are self-incriminating statements made by witnesses : these statements cannot be used against the witness but can be used, under certain conditions, in other proceedings or in respect of other individuals).

Finally case law and doctrine have identified inexistence as the most severe form of invalidity although it is not expressly foreseen by the legislator: it applies, for example, in the case of lack of jurisdiction by the court or when the accused has immunity from prosecution.

Germany

Although German law does not use the concept of nullity, German scholars and courts have developed numerous approaches for deciding on the exclusion of different types of illegal evidence. For example the case law has identified absolute exclusionary rules (absolute *Verwertungsverbote*) which lead to a strict exclusion of evidence and relative exclusionary rules based on grave breach of a rule regulating collection of evidence which include both instances of absolute exclusion of evidence and instances where the judges can weigh the pros and cons for an exclusion (relative *Verwertungsverbote*)⁴⁹.

The first category excludes evidence irrespective of the activities of the law enforcement agency, regardless of misconduct (for example when there had been a violation of the constitutional right to privacy or other constitutionally protected rights). The second category relates to the exclusion of evidence based on its illegal collection in violation of rules concerning its gathering by law enforcement agencies. For example courts ruled that evidence gathered following the bugging the inside of an apartment was declared inadmissible as the law enforcement agencies had only obtained authorisation to bug the outside of a house.⁵⁰

The case law has also included in this category cases where investigation measures were used arbitrarily against somebody⁵¹. In so doing the courts apply a balancing test based on the principle of proportionality⁵². In this case, illegally obtained evidence is excluded only if the interests of law enforcement cannot outweigh those of the defendant⁵³. The circumstances considered include the

⁴⁹ Koriath, H (1994), *Proof in Criminal proceeding [Uber Beweisverbote im Strafprozess]*. P.Lang, Frankfurt am Main/New York

⁵⁰ BGHSt 42,372,377(1.15.1997)

⁵¹ BGHSt 41,30,34 (2.16.1996) and BGHSt 47,362 (8.1.2002)

⁵² BVerfGE 209,7 (1.15.1958); BVerfG,NJW 1962, 2243 (11.9.1962);BVerfG NJW 1963,147 (12.18.1962)

⁵³ BGHSt 47, 172, 179-180 (11.22.2001); BGH NJW 2003, 2034

severity of police misconduct, the importance of the violated legal interest, the seriousness of the crime committed by the defendant and the relevance of the piece of evidence for the resolution of the case⁵⁴.

Normally the violation of a rule securing the defendant's basic procedural rights leads to the exclusion of the evidence obtained. So for example if a suspect is not informed of his right to remain silent or to consult with a defence counsel of his choice, this omission leads to the exclusion of any statement made during his interrogation⁵⁵.

More recently the German courts have introduced an exception to the exclusion of evidence: only if the person, whose rights have been violated during the gathering of evidence objects to the admission of the evidence in a timely fashion, will the exclusionary rule be applied⁵⁶. In other cases courts have held that relevant evidence should not be excluded merely because of a technical fault if the evidence could otherwise have been obtained by legal means⁵⁷.

The United Kingdom: Abuse of process and stay⁵⁸ of judicial proceedings (abridged from: The Crown Prosecution Service - Abuse of Process⁵⁹)

In the United Kingdom the basic principle is that it is for the prosecution, not the court, to decide whether a prosecution should be commenced and, if commenced, whether it should continue.

However, the courts have an overriding duty to promote justice and prevent injustice. From this duty arises an inherent power to 'stay' an indictment (or stop a prosecution in the magistrates' courts) if the court is of the opinion that to allow the prosecution to continue would amount to an abuse of the process of the court. Whilst the courts do not have any power to apply direct discipline to the police or the prosecuting authorities, they can "refuse to allow them to take advantage of abuse of power by regarding their behaviour as an abuse of process and thus preventing a prosecution".

Abuse of process has been defined as something so unfair and wrong with the prosecution that the court should not allow a prosecutor to proceed with what is, in all other respects, a perfectly supportable case. What is 'unfair and wrong' is for the court to determine on the individual facts of each case. The concept of a fair trial involves fairness to the prosecution and to the public as well as to the defendant.

Courts that are asked to exercise their inherent power to stay, usually first consider whether other procedural measures such as the exclusion of specific evidence or directions to the jury might prevent 'trial unfairness' and allow the prosecution to continue.

The leading case on the application of abuse of process is *Bennett v. Horseferry Magistrates' Court*. This case confirmed that an abuse of process justifying the stay of a prosecution could arise in the following circumstances:

- i. Where it would be impossible to give the accused a fair trial; or
- ii. Where it would amount to a misuse/manipulation of process because it offends the court's sense of justice and propriety to be asked to try the accused in the circumstances of the particular case.

⁵⁴ BGHSt 38,372 (10.29.1992)

⁵⁵ BGHSt 11,213 (1.21.1958); BGHSt 38,214,220 (2.27.1992)

⁵⁶ BGHSt 38, 214,225 (2.27.1992); BGHSt 39,349,352 (10.12.1993); BGH JR 2005, 385,386

⁵⁷ BGHSt 24,125 (3.17.1971); See also Thaman S.C. 2001, *Miranda in comparative law*. Saint Louis university law journal 45:581-622

⁵⁸ A stay of proceedings is a ruling by the court in civil and criminal procedure halting further legal process in a trial.

⁵⁹ CPS, *Abuse of process* is available at www.cps.gov.uk/

In *R v. Derby crown court ex parte Brooks* the jurisdiction of abuse of process was defined as follows: “The power to stop a prosecution arises only when it is an abuse of the process of the court. It may be an abuse of process if either (a) the prosecution have manipulated or misused the process of the court so as to deprive the defendant of the protection provided by the law or to take unfair advantage of a technicality, or (b) on the balance of probability the defendant has been or will be, prejudiced in the preparation or conduct of his defence by delay on the part of the prosecution.”

Such principles have been developed in the case law of UK courts. Issues that have raised questions of abuse of process include manipulation of custody time limits, improper motive as a basis for initiation of prosecution, disparity of treatment between co-defendants, selective prosecution, manipulation of witnesses, unlawfully obtained evidence, commission of criminal offences or unlawful conduct on the part of investigators, entrapment or separate prosecution by different prosecuting agencies. A detailed overview of the key examples of abuse of process and case law is provided in the Appendix 1.

3.1.3.4 Disciplinary liability of prosecutors /magistrates

Across the Council of Europe member states, the adoption of codes of conduct for judges and prosecutors has been accompanied by the adoption of measures of administrative responsibility in order to enforce the rules established in the codes of conducts and preserve the trust of citizens.

The strengthening of such disciplinary measures has often been spurred by major scandals reported by the media such as the Dutroux case in Belgium and the Outreau case in France. It should be noted however that not all violations of the codes of ethics might entail the adoption of disciplinary responsibility.

Disciplinary liability regulations usually apply to both judges and prosecutors as in several countries they belong to the same category of magistrates and are supervised by a disciplinary council, such as the high council of the judiciary in Italy and France, which are composed of senior judges and prosecutors as well as lay members or lawyers.

In some countries, such as Serbia⁶⁰ and “The Former Yugoslav Republic of Macedonia”⁶¹ instead there are separate disciplinary commissions for judges and prosecutors. In Belgium the authority competent over the adoption of disciplinary sanctions will usually depend on the judge’s rank and degree of penalty (hierarchical superior for minor penalties, while the minister of justice will be competent for major first degree penalty while the king will apply sanctions for major second degree penalties)⁶². In Germany disciplinary sanctions are commuted by the Attorney General, while in Finland such powers belong to the Ministry of Justice and an Ombudsman⁶³. More recently some countries, such as the Netherlands and Spain⁶⁴ have adopted the possibility to open procedures for disciplinary violations following petition of the individuals affected by a given measure or behaviour. In Finland this possibility is open even to individuals who were not directly affected by the measure although the competent disciplinary commission functions as a gatekeeper.

The adoption of disciplinary sanctions is also coordinated with penal sanctions either to avoid a violation of the principle *non bis in idem* or to attach given disciplinary sanctions once a criminal conviction had been adopted. For example in Finland certain violations committed by a magistrate in the exercise of his duties are accompanied by a compulsory additional sanction such as revocation. This is the case of corruption or abuse of public office. It should be noted that however, in Finland,

⁶⁰ Law n° 116/08 of 27 December 2008 on Public Prosecution, on Judges, on High Judicial Council

⁶¹ Law on the Judicial Council of the Republic of Macedonia adopted in 2006, No 60/2006

⁶² Judiciary Code [Code Judiciaire], art. 398-427

⁶³ Federal Law of 9 July 2001 for federal servants; Federal Law of 8 September 1961 on the Magistrate; Basic Law for the Federal Republic of Germany of 23 May 1949.

⁶⁴ Organic Law on the organisation of the Judiciary, [Ley Organica del Poder Judicial 2014]with explanatory report:

while public officials who commit such violations can be revoked by administrative decision, in the case the same violation is committed by magistrates, a judicial decision will be required. In 2005 a group of experts created by the Ministry of justice proposed an amendment to the current legislation whereby a judge can be revoked even in cases his conviction only entail a fine. Such proposal was based on the importance attached to confidence in the judicial system that requires that a judge will not hold his office even in cases where he committed non-serious violations.

In the Netherlands, a magistrate can be suspended if he is in pre-trial detention or has been convicted for a crime before the decision has not yet entered into legal force while once he is convicted with a final judicial decision a judge will be dismissed.

France

Although there is no code of ethics, the high council of the judiciary in 2009 issued ethical guidelines detailing personal, functional and institutional values which are specified through specific duties: for example the requirement of integrity and probity entails the prohibition to use a magistrate's position to obtain personal benefits, efficient carrying out of duties and rejection of favouritism⁶⁵.

The 1958 law on the rights obligations and career of members of the judiciary⁶⁶ does not mention expressly violations of principles while off duty but it is clear that private misconduct is considered as breach of discipline.

Following a 2008 constitutional reform⁶⁷, disciplinary proceedings may be initiated not only upon initiative of the ministry of justice and chief prosecutor but also following complaint of an affected individual for violation of legal terms which is considered a disciplinary offence. The Inspectorate general of judicial services carries out the inquiry into the alleged violations.

As a person subject to trial the prosecutor is discharged of the proceedings and the complaint must be submitted within a year from the definitive decision. The hearings in the disciplinary proceedings are public. Such guarantees have been adopted in 2010 in order to increase the transparency of the system for disciplinary sanctions, which also accompanies by the regular publication by the high council of magistrates of the integral text of the disciplinary decisions and opinions (although the name of the affected magistrate is omitted).

The French legislation provides for a long list of disciplinary sanctions which can be summaries in moral sanctions such as reprimand, censure or admonition, financial sanctions such as fines or reduction of remuneration and serious sanctions such as transfer, suspension of duties, devolution and dismissal.

Spain

The law on judiciary adopted in 1985 provides for a clear and precise disciplinary system for magistrates.⁶⁸ Disciplinary liability is by large the most frequent form of judicial accountability. The law identifies three categories of disciplinary offences: very serious offences, serious offences and minor offences, intentional misconduct affecting constitutional rights and obligations, lack of respect for the hierarchy or unjustified or without cause non-observance of time limits. Disciplinary liability is by large the most frequent form of judicial accountability. Petty offences carry the sanction of a warning or fine, serious offences a fine of up to 6,000 euro while very serious offences lead to the removal from judicial office or dismissal from the judiciary.

⁶⁵ *Code of conduct of judges* [*Recueil des obligations déontologiques des magistrats*] available at www.conseil-superieur-magistrature.fr/

⁶⁶ Ordinance nr. 58-1270 of 22 December 1958 [*Ordonnance n°58-1270 du 22 décembre 1958*]

⁶⁷ *Constitutional Law 2008-274 on modernisation of the institutions* [*Loi constitutionnelle n°2008-274 du 23 juillet 2008 de modernisation des institutions de la Vème République*]

⁶⁸ *Organic Law 6/1985*, [*Ley Orgánica 6/1985, de 1 de julio, del Poder Judicial(LOPJ)*], partially modified by the new LOPJ entering into legal force in July 2014.

The types of offences that give rise to disciplinary responsibility are regulated in detail. For example, very serious offences leading to removal from judicial office or dismissal, include interference by any means in the exercise of the judicial function, repeated provocation of serious clashes with the local authorities for reasons not pertaining to the exercise of his duties, ignoring the duty to abstain from the exercise of judicial functions in cases where recusal is foreseen by the law, negligence or unjustified and repeated delay in the initiation, prosecution or conduction of criminal prosecutions or in the exercise of other professional duties, provision of false information in requesting permits, authorisations, statements on conflict of interest, economic contributions, the disclosure of information obtained the performance of official duties when this disclosure interferes or harms the proceedings or any individual, inexcusable ignorance in the carrying out of professional obligations, absolute and clear failure to motivate his decisions upon condition that the failure has been established with judicial decision entered into legal force, the commission of a serious offence if it had been preceded by two other sanctions for serious disciplinary offences, lack of motivation of decisions that require it, provided that such failure has been appreciated in a judicial decision.

Different authorities on the basis of their gravity apply disciplinary sanctions, so for example only the plenary of the council general of judiciary can decide over the removal or dismissal of a prosecutor following proposal of the disciplinary commission. However the hearings are not public.

Sometimes facts could be seen as criminal acts and disciplinary acts: malicious delay of rendering justice or judicial malfeasance. In these cases both procedures may start at once however a disciplinary procedure will be suspended until the adoption of the decision in the criminal proceedings. If a judge is convicted in a criminal process, no disciplinary sanction is given. It should be noted that according to the new law on the judiciary (*Ley Organica del Poder Judicial*) criminal liability for judges arises for any crime committed in the exercise of a magistrate's duty.

Italy

The Legislative Decree No. 109/2006 – provides for a detailed list of fundamental duties to be complied with by magistrates while exercising the judicial functions. They are basic principles and ethical values for practitioners of the judicial functions and sets forth duties widely recognised by legal scholars and case law. Reference is thus made to the duty of impartiality, propriety, diligence, commitment, confidentiality, balance and respect for the dignity of individuals as the fundamental principles to be complied with when exercising the judicial functions.

The “rules regulating breaches of discipline by magistrates, relevant sanctions, and application procedure” – divide breach of discipline into two categories: on the one hand, cases of breaches committed in the exercise of the judicial functions, and on the other, cases of breaches committed out of court.⁶⁹

The decree identifies breaches of discipline that result from the commission of an offence, establishing a kind of automatism between the facts at the basis of a conviction for an intentional offence and disciplinary proceedings. This automatism does not apply to unintentional offences punished by imprisonment unless they particularly serious in view of the modalities used to commit the act and its consequences.

⁶⁹ Disciplinary sanctions may be applied for breaches in the exercise of their functions and for breaches perpetrated out of court. The former may include behaviours that caused unfair damage or unfair advantage to one of the parties, conducts that are normally or seriously unfair to the parties, violations of the law caused by inexcusable ignorance or negligence and the misinterpretation of facts caused by inexcusable negligence. The latter may include using the title of prosecutor or investigator to obtain an unfair advantage for oneself or others, seeing people who are under investigation or have prior convictions or are known to be habitual or professional criminals, knowingly doing business with the persons mentioned above, participating in associations whose membership is objectively incompatible with the exercise of public functions, or involvement in the activities of individuals working in the economic or financial sector who can condition the exercise of their function or in any case jeopardize the image of a prosecutor or investigator.

The second section of the legislative decree provides for different types of sanctions, which are adapted to the individual breaches of discipline described above. The law, in fact, introduces the criterion of *tale crimen talis poena*, as a consequence of the typification of the breaches.

The various sanctions are:

- a) a warning, which formally invites the magistrate to comply with his duties;
- b) a censure, which is a formal statement of disapproval;
- c) loss of seniority, which cannot be of less than two months and more than two years;
- d) temporary incapacity to exercise an executive or semi- executive position, which cannot be for less than six months and more than two years;
- e) suspension from functions, with is the suspension from the functions, the salary, and the magistrate is placed out of the rolls of the Judiciary; and
- f) removal from office, with the termination of employment.

There is also the accessory sanction of enforced transfer that a disciplinary judge can apply when imposing a sanction stricter than a warning. Such additional sanction is always adopted in given specific cases identified by law.

An enforced transfer can also be ordered as a precautionary and temporary measure when there is circumstantial evidence of the breach of discipline and there are reasons of particular urgency.

Finally the decree foresees the obligatory suspension from exercise of his functions of a magistrate who has been subjected to pre-trial detention or other measures of restraint. Suspension is facultative in case of on-going criminal proceedings as well as disciplinary proceedings for grave violations, which are incompatible with the continuation of the exercise of his functions.

3.1.3.5 Civil liability of magistrates

According to Article 5(2) of the European Charter on the statute of judges adopted in 1998 “compensation for harm wrongfully suffered as a result of the decision or the behaviour of a judge in the exercise of his or her duties is guaranteed by the State. The statute may provide that the State has the possibility of applying, within a fixed limit, for reimbursement from the judge by way of legal proceedings in the case of a gross and inexcusable breach of the rules governing the performance of judicial duties”.

State liability of the State for damages caused by magistrates in the exercise of the judicial function is adopted in about all of the CoE members. Even in cases where it is possible for the state to file an action in contribution against the magistrate, the conditions for such actions are fairly restrictive and hardly ever applied. A notable exception is **Belgium** where a victim of denial of justice or grave judicial mistakes is able to choose whether to file a lawsuit against the state or the judge himself⁷⁰. Such instances are limited to cases of malicious prosecution or fraud in the investigation or in case a magistrate had been held criminally liable for violations in the discharge of his duties.

The type of fault that usually generates state liability in CoE state members is limited to grave fault such as the inexcusable violation of legal provisions or negligence in the assessment of facts such as falsely affirming that a fact has taken place. In Italy for example an intentionally grave fault committed in the discharge of duties or denial of justice will be required, while Serbian Judges act talks about of illegal and incorrect work (Article 6).

The interpretation of facts, assessment of the law and evidence cannot engage the responsibility of the judge except for intentional violations or violations of exceptional gravity. In France a similar approach is adopted for cases when the exercise of the judiciary function has caused an abnormal and

⁷⁰ *Code Judiciaire*, art 1140

exceptional damage to the victim⁷¹.

France

According to the *Code de l'organisation judiciaire*⁷² the state is liable for breach in the exercise of judicial duties only in case of *faute grave* (gross violation/grave fault) or denial of justice. Such rules clearly restrict the instances when the state may be held liable for the malfunctioning of its judiciary function. On the other hand the case law of the courts has sensibly softened the application of this rule. For example the jurisprudence has narrowed the concept of grave fault to those mistakes so gross that a magistrate normally aware of his duty, could have not committed it, or to cases of grave and inexcusable ignorance of the essential duties of a judge in the exercise of his functions, . Grave fault has also been described as an inefficiency characterised by the commission of a fact or series of facts showing the inability of the magistrate to discharge its function.

Through this interpretation civil liability will be considered as having taken place whenever there is a malfunctioning of the judiciary irrespective of psychological elements of those magistrates involved. Denial of justice has instead been identified with delay in the exercise of functions.

Law of 5 March 2007 has introduced a specific provision linking civil liability of magistrates with disciplinary responsibility: whenever the state has been condemned to compensation for damages arising from civil liability of a magistrate, a procedure for the adoption of disciplinary sanctions may be initiated if there are grounds to believe that the violation is imputable to the fault of the magistrate.

Italy

The law affirms the principle of the right to compensation for any unfair damage resulting from the conduct, decision or judicial order issued by a magistrate either with "intention" or "serious negligence" while exercising his functions, or resulting from a "denial of justice" (Article 2). The law nevertheless clarifies that the activities of interpreting the law and assessing the facts and evidence (Article 2, paragraph 2) cannot give rise to such liability. In this respect, in any such cases, it is the procedure itself which safeguards the parties, i.e. by resorting to the system of appeals against the order assumed to be defective.

It should be noted however that in November 2011, the European Court of Justice, in the case C-397/10 (Commission v. Italy) held that the national provisions preventing compensation for damages where a court had misconstrued EU law, or assessed the facts or evidence save when there was intentional fault or negligence was unduly stringent. The Court also held that if a Member State can be held liable for damage caused by the courts only in exceptional cases where the court has manifestly infringed the applicable law, national law cannot provide for further requirements. The interpretation given by the Italian Supreme Court to the concept of serious misconduct was held to impose stricter requirements than those deriving from the condition of manifest infringement of the applicable law.⁷³

In case of violations committed by magistrates the victims are usually able to file a lawsuit either against the state or against the individual magistrate or both. Usually the state can also, if subjected to civil liability, act against the violating magistrate to recover the damages paid to victims of denial of justice or grave errors; however such events are quite rare, as they usually require the intentional

⁷¹ Julie Joly-Hurard (2006), *Civil, criminal and disciplinary Liability*, [La responsabilité civile, pénale et disciplinaire des magistrats, *revue internationale de droit comparé*], 2006, vol 58(2), pp.439-475

⁷² *Code on the organisation of the Judiciary* [*Code de l'organisation judiciaire*] is available at www.legifrance.gouv.fr/

⁷³ In the jurisprudence of the court it was noted that a member state of the EU is required to make good damage caused to individuals as a result of an infringement of EU law by state bodies, where three conditions are met: a) the rule of EU law infringed must confer rights on the individuals, (b) the infringement must be sufficiently serious, and (c) there must be a direct causal link between the breach of the obligation on the State and the damage sustained by the individual. A sufficient serious breach of a rule of EU law arises where the national court has manifestly infringed the applicable law. National law may define the nature or the degree of a breach resulting in state liability but on no account may it impose stricter requirements.

commission of a grave violation on the part of the magistrate.⁷⁴

In Italy the liability for compensating damage rests with the State, against which an injured party may take legal action. If the State's liability is established, then the State may, subject to certain conditions, in turn claim compensation from the judge/prosecutor.

A liability action and relevant proceedings must comply with specific rules. The most important of these rules provides for liability proceedings to be subject to: the lodging of all ordinary means of appeal, including any other remedy for amending or revoking the measure that is assumed to have been the cause of unfair damage; the existence of a deadline for exercising such action; a decision on the action's admissibility, for the purposes of checking the relevant prerequisites; observance of the terms; an assessment of the evidence to see whether the charges are grounded; and the judge's power to intervene in the proceedings against the State.

In order to guarantee the transparency and impartiality of the proceedings, the system prescribes for the jurisdiction over such proceedings to be transferred to a different judicial office, to ensure that the proceedings are not assigned to a judge of the same office as the office of the magistrate whose activity is assumed to have given rise to an unfair damage.

In this respect, under Law no. 420 of 2 December 1998, the rules governing jurisdiction over such proceedings have radically been reformed. In addition to transparency, the aim of this reform was to ensure a judge's maximum autonomy of decision when called on to decide cases in which other colleagues are involved for whatever reason. Significant changes were made to the rules of civil procedure by creating a mechanism that establishes the competent judge to avert the risk of "reciprocal" (or "crossed") jurisdictions.

Spain

Following the entering into force of the new law on judiciary power in July 2014 (*ley Organica del Poder Judicial –LOPJ*), the direct civil liability for judges has been excluded. Such amendments were considered to be in line with similar provisions affecting public officials and also correspond to a reality of judicial practice whereby such provisions were hardly ever applied. Hence lawsuits for civil liability for damages can be only filed against the state for maladministration of justice and for judicial errors (*por error judicial o por funcionamiento anormal de la Administración de Justicia*). The only instance where the state will not be held liable for such violations is force majeure.

In case of judicial errors, state responsibility arises only in case of manifestly erroneous judicial decision including decisions of prosecutors involved in judicial proceedings.

Damages will be awarded if they were effectively incurred, economically assessable and individualised in relation to a person or group of persons. The fact that a decision has been declared null and void /annulled does not per se entail the right to compensation for damages.

On the other hand it is possible for the state to file an action in contribution against judges, in case of *dolo* or *culpa grave*. It will also be possible, on this basis, to adopt disciplinary sanctions against the magistrate.

According to the new Law on the Judiciary (*Ley Organica del Poder Judicial*) compensation for damages is also awarded in cases when pre-trial detention has not been followed by a criminal conviction. According to the new provisions it will not be necessary to previously establish that a judicial error took place in order to award damages, as the right to compensation will arise

⁷⁴ The same approach is adopted by Germany, Italy and the Netherlands. The action in contribution against the judge in Italy is further limited to instances of malicious intentional violations. Overall cases of magistrates held liable for violations are fairly exceptional.

automatically. Such amendment has been adopted in order to comply with the right of accused individuals to be presumed innocent following finding of violations by the ECtHR.⁷⁵

3.1.4 Conclusions

In a well-regulated system the use of powers by public officials who carry out criminal investigations and prosecution should be appropriately limited and subject to legal checks.

Although in recent years Russian courts have increasingly strengthened the review of investigative action, abuse of criminal investigation and prosecution remains a major issue. So-called “commissioned prosecutions” (*zakaznye dela*) are probably the most clear-cut examples of criminal legal abuse in Russia. The term has been used to refer both to criminal cases “commissioned” by third parties as a way of sabotaging business competitors and to criminal cases initiated by law enforcement for extortionate or other improper purposes.⁷⁶ There is in fact a frequent overlap of corrupted commercial motives between these two types of cases, the techniques are similar and they raise common legal issues.⁷⁷ Extortionate prosecutions have expanded to target legitimate businesses, a feat accomplished by the creative use of legal loopholes and ambiguities to create a threat of criminal prosecution, which would not otherwise exist. In other instances, violations committed in the framework of legitimate criminal investigations may simply find their explanation in loopholes in the current legislation and judicial practice. They nevertheless create disproportionate interferences with the ability of a company to carry out its business activity⁷⁸ or with its right to peaceful enjoyment of property.

An analysis of international and European best practices shows the existence of a plurality of mechanisms that have been adopted to ensure that the need for effective prosecution of crimes does not encroach on the protection of defence rights. A common trend among European countries is the strengthening of judicial review over the investigation stage through the creation of specialised judges who are charged with the review of investigative action and with deciding over the adoption of measures such as a pre-trial detention, eavesdropping as well as the taking of certain evidence.

In France investigations are carried out by the police under the supervision of the *procureur*, or the *juge d’instruction*, and the trial court’s function is not only to pass judgment on the evidence presented by the parties, but to conduct its own enquiries into the case in order to satisfy itself of the guilt or innocence of the accused.

Although the trial represents an important (and publicly accountable) hearing of the case, historically, much emphasis had been placed on the pre-trial phase. The investigation is regarded as a judicially supervised enquiry into the offence and the evidence surrounding it, rather than the gathering of evidence to support the prosecution of the accused.

Any issues concerning the deprivation of liberty of the person under investigation is decided by a specialised court: the *juge des libertés et de la détention*.

In Italy, a judge for the preliminary investigations and a judge for the pre-trial hearings are specialised judges who decide, respectively over any measure affecting the rights and liberties of an individual under investigation and over whether there is sufficient evidence for committing an individual to trial.

In Germany interrogation under oath during the investigation can be done only by a judge and not by investigators or prosecutors.

⁷⁵ See for example the judgment in the case *Tendam v. Spain* App. No 25720/05

⁷⁶ *Skoblikov, Korruptsiya v. Sovremennoi Rossii* 33-34 (2009)

⁷⁷ Thomas Firestone, *Armed Injustice: abuse of the law and complex crime in post-soviet Russia*, *Denv. J.Int’l L & Pol’y* Vol 38:4

⁷⁸ Article 34 of the Russian Constitution states that “Everyone shall have the right to a free use of his abilities and property for entrepreneurial and economic activities not prohibited by law”.

In the Netherlands and United Kingdom the courts, as an *extrema ratio*, have been empowered to stay prosecutions when due to the gravity of violations it has become impossible to give the accused a fair trial or when allowing a continuation of a prosecution would amount to misusing the justice system. Stay of prosecutions in United Kingdom responds to the basic principle that although it is for the prosecution to decide whether a prosecution should be commenced and continued (or discontinued), the courts have an overriding duty to promote justice and prevent injustice. The courts have developed in this respect an extremely detailed case law addressing issues such as prosecutors' improper motives, disparity of treatment of co-defendants, abuses of witness cooperation, selective prosecutions, manipulation of evidence, entrapment.

Besides a strengthened judicial review over the investigative stage, the protection of defendants' rights is ensured by a detailed regime of nullities of investigative acts that have definitely played a role in preventing and curbing violation of defence rights and in certain cases have brought an investigation to a halt (France and Italy).

Finally a detailed regime of disciplinary sanctions and civil and criminal responsibility of judges and prosecutors have been enacted throughout CoE member states. A notable aspect of the regulation of disciplinary sanctions has been the introduction of an extremely detailed regime of grounds justifying their adoption. Such specificity united with automatism in their application has been deemed necessary to ensure not only that that disciplinary sanctions effectively tackle and deter violations of defence rights committed by investigative authorities and prosecutors in respect of a specific case but also that impartiality, propriety, diligence, commitment, confidentiality, balance and respect for the dignity of individuals are enforced.

3.2 Search, arrest of property, identification, freezing, management and confiscation of the proceeds of crime

Seizure of property is a necessary tool to ensure gathering of evidence in criminal investigation, confiscation of proceeds of crime and satisfaction of civil claims that may arise during criminal proceedings. However, it can be misused in a number of principal ways, for example:

- Arbitrary seizures with missing or vague grounds;
- Seizure of such property, which is obviously disproportionate, inadequate or unrelated to the legitimate needs of gathering evidence or recovering the proceeds of crime;
- Seizure with no regard to the reputation loss or other damage done by this act to the legitimate performance of an enterprise (e.g. indiscriminate seizure of originals of documents);
- Failure to preserve the integrity of the seized property or otherwise handle it properly (including making of corrupt benefit from the seized assets);
- Unreasonably lengthy arrest of assets.

3.2.1 The Russian Federation

The rights and legitimate interests of individuals and organisations who are victims of crime can be protected only when real and full compensation for the harm is available. Hence the effectiveness of the legal framework for the creation of conditions, which enable proper implementation of judicial decisions, is particularly important.

Imposition of arrest on property (Articles 115-116 of the Code of Criminal Procedure) is a preventive and coercive measure, which restricts the property right (other proprietary rights) to prevent the concealment or alienation of the property in order to ensure the execution of the sentence in the part concerning asset claims. Arrest of property is conditioned on the actual possibility to seize the property and substantiated assumption as to the possible concealment or alienation of the property.

The imposition of arrest on property significantly restricts the constitutional rights of the individual. It is permitted only under one or several special conditions:

- Pecuniary or moral damage caused by the crime has been established, civil action is pending;
- There is a possibility of confiscation of property as a part of the penalty, i.e. the person whose property is seized must reasonably be suspected or accused of committing a premeditated crime for mercenary motives, which carries a penalty of more than 5 years imprisonment;
- The amount of the incurred court fees, which may be imposed on the accused, has been established.

Arrest on property is possible both in the pre-trial and the trial stage. However, the procedure of application of this measure differs depending on the stage of the criminal proceedings.

During the trial, the judge, in accordance with Article 230 of the Code of Criminal Procedure, upon the request of the victim, civil plaintiff or their representatives, or the prosecutor, may order the adoption of measures to guarantee the compensation of damage caused by the crime or the possible confiscation of property. All participants of the criminal proceedings from the side of the prosecution have the right to initiate measures for civil action.

During the pre-trial stage, only the officers engaged in the preliminary investigation may initiate measures to be adopted by the court aimed at ensuring the enforcement of the civil action. The Code of Criminal Procedure does not grant the victim and civil plaintiff as well as their representatives the right to ask independently the court to impose arrest on the property of a suspect or the accused. In accordance with Article 115 of the Code of Criminal Procedure, the investigator with the consent of the head of the investigative body as well as the inquiry officer with the consent of the public prosecutor shall file a court motion to seize the property of a suspect, accused person or persons with pecuniary responsibility for their actions.

The imposition of arrest on property prohibits the owner or holder to dispose of it and, where necessary, use it. The property is seized and transferred for storage to its owner or holder or other person who shall be warned about responsibility for the preservation of the property. Despite such warning, violations still often occur when, for example, persons with whom the seized assets are deposited make profit.

Box 3. Example of the misuse of arrest of property

“When criminal investigation is opened an investigator can arrest merchandise as physical evidence. Seized goods have to be stored in special government warehouses. In case of perishable goods or goods which may quickly become obsolete, it is possible to sell them. Such regulations create wrong incentives to law enforcers. In the mid-2000’s almost every firm on Moscow’s electronics market faced a situation when investigators offered to buyout seized goods. Sometimes law enforcers sold confiscated goods to an affiliated company for 10% of its market value. Evroset, a mobile phone retailer with assets valued at \$2.5 billion, was among such companies. Motorola was also involved in this case.

The manufacturer shipped mobile phones for Evroset which were confiscated in March 2006 as smuggled goods and later on special press-conference declared as “not designed for use in Russia”, and, finally, even as “health hazardous”. The U.S. office of Motorola tried to dispute the statement that their phones were improper. Motorola’s top management asked George W. Bush to discuss this problem with V. Putin. After the G8 Summit hosted in Russia 117,500 phones were returned to Evroset. Though officials said 50,000 phones of 167,500 confiscated in total had been destroyed, afterwards approximately 30,000 of obliterated items were sold on the grey market. One of the consequences of this scandal was the transfer to another position of Attorney General Vladimir Ustinov and dismissal of Alexander Zherihov, Head of Federal Customs Service of Russia. Evroset filed a suit for abuse of office. Two officials were punished, with one of them sentenced to 1 year in prison, and with the other obliged to pay a fine of \$2,000. After this “*siloviks*” started to seek vengeance both upon Motorola and Evroset. They impound all the business document of both

enterprises. Finally this campaign transformed into personal persecution of Evroset's owner Y. Chichvarkin, who sold his business and sought political asylum in London in 2008. In April 2010 Chichvarkin's mother was found dead in her apartment. Along with some media, Mr Chichvarkin suspects that she was murdered to urge him to return to Russia. He was vindicated from charges in January 2011 but refuses to return to Russia."⁷⁹

Arrest may be imposed also on property found with other persons if there are reasonable grounds to believe that it was obtained as a result of criminal acts of the suspect or accused person or used or intended for use as an instrument of crime, or for financing of terrorism, organised group, illegal armed group, criminal association (criminal organisation).

The decision of the High Court of Arbitration of the Russian Federation of 31 October 2011 VAS - 11479 N/11 in the case N A41-40197/09 may serve as an example of an imposition of arrest on property. The grounds for bringing this criminal case was the fact of fraud aimed at the acquisition of immovable property of the plaintiff in the course of economic activity of the latter.

In accordance with the Decree of the Presidium of the High Court of Arbitration N 8609/08 of 25 November 2008, the court may not consider a dispute involving protection of the ownership right if the restrictions of that right were a consequence of the adoption of coercive measures imposed by the court of general jurisdiction in criminal proceedings in accordance with part 2 Article 115 of the Code of Criminal Procedure because the arrest of the disputed property is necessitated by the needs of a public criminal proceedings.

In accordance with part 7 of Article 115 of the Code of Criminal Procedure, arrest on cash and other valuables in the account, deposit or storage in banks and other credit organisations entails a prohibition of transactions in this account in whole or in part concerning the arrested assets.

3.2.2 International standards and good practices: identification, freezing, management and confiscation of the proceeds of crime

Obtaining financial benefits is one of the main goals of those committing serious crimes and so the recovery of assets which are the proceeds of crime has become a key strategy of the fight against crime at both an international level and within the national system of all EU members.

The UN has adopted the Convention against Corruption and it places particular emphasis of the confiscation of the proceeds of crime. The UNODC has issued model provisions on money laundering, Terrorist financing, preventive measures and proceeds of crime. Recommendations have been issued by the Financial Action Task Force (FATF) concerning asset freezing and confiscation of proceeds of crime in the framework of the fight against money laundering (FATF International best practices and guidelines on recommendation 4 and 38 on confiscation). The G8 group has issued Best practice principles on Tracing, Freezing and Confiscation of Assets, and Best practices for the administration of seized assets. The Council of Europe has adopted two conventions: the CoE Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime 1990 141 and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism 1990 Warsaw, 16.V.2005. Other international organisations have included the regulation of freezing and confiscation of proceeds of crime in the framework of conventions and agreements, (e.g. the OECD agreement on the fight against the corruption of foreign public officers in international business transactions).

The EU has adopted a criminal law policy that focuses on the confiscation of proceeds of crime with the intention that, by "following the money" and depriving criminals of the proceeds of crime, crime

⁷⁹ Nazrullaevay, E., Baranovz, A., Yakovlev, A. (2013) *Criminal Persecution of Business in Russia's Regions: Private Interests vs. "Stick" System* (draft version 2.1), p. 9

will be deterred more effectively than simply by resorting to measures such as the deprivation of liberty.

The “Millennium Strategy” against organised crime includes recommendation 17(b), under which member states will have to consider the possibility of creating units dedicated to tracking, seizing and confiscating assets, and to ensure that such units have sufficient staff, technical and operational resources for the fight against money laundering. With framework decision 2003/577/JAI (on the enforcement of orders freezing property or evidence) the Commission has sought to achieve stronger cooperation among its member states through the principle of mutual recognition of orders of provisional attachment.

All of these international instruments seek to balance the need for an effective fight against crime with the protection of the rights of individuals to be free from interference into their private lives as well as the right to be presumed innocent, to the peaceful enjoyment of possessions, to effective judicial remedies and to the right to a fair trial.

3.2.2.1 The importance of the financial investigation

The carrying out of a financial investigation has become an essential part of any criminal investigation intended to determine the proceeds of crime. Not only do such investigations ensure the efficient identification and tracking of the proceeds of crime but they also prevent disproportionate asset seizures. Traditionally proceeds resulting from a concrete criminal offence under investigation are the only property that can be frozen (CARPO manual on financial investigations).

The FATF’s Operational issues - Financial Investigation Guidance underlines how one of the biggest challenges in asset recovery investigations is producing the evidence that links the assets to the criminal activities (i.e. property-based confiscation) or proving that assets are a benefit derived from an offence committed by the target (i.e. value-based confiscation). To establish this link, investigators must identify and trace assets so that their connection to the offence or location of the assets can be determined.

The Council of Europe CARPO training manual on financial investigations and confiscation of proceeds from crime (development of reliable and functioning policing systems and enhancing of combating main criminal activities and police cooperation) states that a well-developed financial investigation is a precondition for a successful confiscation proceeding.

In order to ensure a final confiscation, it is necessary to have efficient investigative provisions to identify, trace and freeze property which is liable to confiscation in order to prevent any dealing in, transfer or disposal of such property and facilitate the confiscation later on.

A financial investigation aimed at identifying the proceeds of crime should take place in parallel with the wider criminal investigation.

The goal of the financial investigation is to:

- collect evidence on the accused and the criminal offence as part of the criminal investigation;
- determine the type and amount of the proceeds of crime;
- determine the property that can be confiscated;
- determine the conditions for asset freezing.

Financial investigation usually requires specialised training or/and the creation of a financial investigation unit. The existence of specialised officials ensures that some of the typical problems of ordinary investigations are overcome: the establishment of a sufficient connection between a crime and certain assets, in order to avoid unlawful and disproportionate attachments, the reliable identification of beneficial owners of assets to be seized (for example through the creation of

databases with information about owners of certain assets), and the carrying out of complex analysis within the time limits of the investigation.

In France, for example, Article 704 of the CCP has introduced the exclusive jurisdiction of certain district courts and investigative authorities specializing in the prosecution and investigation of economic and financial matters but also in complex cases that require the use of specific expertise: eight inter-regional specialised courts (JIRS), located in Paris, Lyon, Marseille, Lille, Rennes, Bordeaux, Nancy and Fort de France, are responsible for the investigation, prosecution, preliminary inquiry and judgment of the most complex cases, and have access to innovative investigative techniques such as infiltration, wiretapping, and the use of joint investigation teams from several countries. The investigative judges working at these courts undergo specific training and must have at least four years of professional experience. Judges are also supported by specialised assistants in technical matters. They come both from the private (accountancy experts, etc.) and the public sector (tax inspectors, customs officers, officials from the Bank of France, etc.). In 2013, the National Assembly adopted an act setting up a specialised financial prosecutor service with jurisdiction at national level in corruption and major tax fraud cases.⁸⁰

Just as criminals rely on the advice of financial experts, in order to increase the complexity of their economic crimes and to hide more easily their criminal activity, it is essential for Law Enforcement Agencies to have the support of similar experts, whose knowledge and previous professional experience can be a key weapon in the fight against crime. Specialised Financial investigation units have been created in virtually all European countries.

3.2.2.2 Use of compulsory measures to obtain evidence: protection of fundamental rights in the context of searches, seizures and other investigative measures

FATF operational guidance states that: “Compulsory measures to obtain evidence, including the use of search warrants and other instruments, should be used to gather evidence of criminal activity that cannot be obtained by other means”.

The execution of these powers should be properly planned and be lawfully conducted in accordance with existing policies and procedures. Moreover, to protect the integrity of evidence, investigators should adhere to the established policies and procedures for the handling of evidence, including chain-of-custody documentation. If such policies and procedures are not already in place, states should introduce them.

Adherence to such policies and procedures protects the integrity of evidence as it is introduced into court proceedings. Attempts to access electronic data or transport and store electronic evidence by untrained investigative personnel, without the necessary equipment may result in unintentional tampering and/or permanent loss of valuable evidence. In all instances, original digital evidence should be deposited in an appropriate evidence container and written records should be prepared. Analysis of this evidence should be conducted by a computer forensic specialist.

3.2.2.3 ECHR case law concerning searches

The European Convention on Human Rights provides protection for companies against searches and seizures in Articles 3, 8, and 13, and Article 1 of Protocol No. 1.

The Court has determined that Member States may consider it necessary to resort to measures such as searches of residential premises and seizures in order to obtain physical evidence. It is recognised that such measures normally interfere with a person’s rights under paragraph 1 of Article 8. Therefore, the justifications for such measures must be relevant and sufficient and not disproportionate to the aim pursued. Moreover, the Court must be satisfied that the relevant legislation and practice afford

⁸⁰ Law 2013/1117, [*Loi 2013/1117 du 6 décembre 2013 relative à la lutte contre la fraude fiscale et la grande délinquance économique et financière*] JORF n°0284, 7 December 2013, available at www.legifrance.gouv.fr/

individuals adequate and effective safeguards against abuse. The case law has thus concentrated on the requirements that searches be “lawful” and conducted with adequate procedural safeguards against arbitrariness and abuse.

Although Article 8 originally aimed at the protection of physical persons in their residences, later developments have allowed such protection to extend to business premises. The Court acknowledges that in certain circumstances the rights guaranteed by Article 8 could be construed to include the right to respect for a company's head office, branch office, or place of business.

In a case (*Colas Est v. France*) involving road construction companies that had been fined for illicit practices following an administrative inquiry the Court found that investigators had entered the applicants' premises without a warrant, which amounted to trespass against their "home". The relevant legislation and practice did not provide adequate or sufficient guarantees against abuse. The Court considered that, at the material time, the relevant authority had very wide powers and that it had intervened without a magistrate's warrant and without a senior police officer being present.

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In a recent case (*Kolesnichenko v. Russia*) the Court outlined several factors to be considered when issuing a search warrant:

- The severity of the offence;
- The legal and factual basis for the warrant (e.g. whether it was issued by a judge or a judicial officer, whether there was a reasonable suspicion);
- The scope of the search;
- The possibility of after-the-fact judicial scrutiny;
- The possible repercussions on the work and reputation of the persons affected.

In this case the Court found a violation of Article 8 because the search was not based on a reasonable suspicion, was not founded on relevant and sufficient reasons, and was not drafted with sufficient precision, thus granting officers unreasonably broad powers.

Another case (*Van Rossem v. Belgium*) concerned the investigation and seizure of documents from corporate offices and the failure of the authorities to draw a list of the documents seized. The ECtHR held that a search warrant must be accompanied by certain limitations with regard to the right to respect for a person's home. The warrant had, therefore, to contain a minimum number of indications so that it was subsequently possible to verify whether the police officer who enforced it had complied with the scope of the investigation thus authorised. In the present case, the search warrants ought at least to have contained the same information as that included in the public prosecutor's application for an investigation. The fact that the investigators would have known what they were to look for could not be considered a determining argument. In the court's opinion the determining element was whether the person or persons whose premises were being searched, or a third party, had sufficient information about the proceedings to enable them to identify, prevent and challenge any abuse.

Further examples

Cases where the Court has condemned states for violations committed in the course of investigations include the following:

- when the investigative authorities had extremely wide powers to assess the expediency, number, length and scale of inspections. The relevant legislation and practice did not provide adequate or sufficient guarantees against abuse (*Miaihle v. France*, *Funke v. France*);
- when the search warrant allowing the national authorities to search for documents and objects important for the investigation did not specify which items and documents were expected to be found in the applicant's office, or how they would be relevant to the investigation (*Van Rossem v. Belgium*);
- when search warrants were drawn up in terms which were too broad and the search impinged on the professional secrecy of some of the materials that had been inspected (*Smirnov v. Russia*, *Kamenzind v. Switzerland*);
- when the search warrant did not ensure the protection of professional secrecy and left unrestricted discretion to the police in determining which documents were "of interest" to the investigation (*Aleksanyan v. Russia*);
- when the search warrant did not contain any order concerning the on-going investigation;
- when the search order had not been based on a reasonable suspicion against the applicant;
- when the search did not pursue the legitimate aim of preventing crime and protecting the rights and freedoms of others;
- when, in the absence of any requirements of a judicial warrant the restrictions and conditions provided for in law appeared too lax and full of loopholes, making the interference in the applicant's right not proportionate to the legitimate aim pursued (*Funke v. France*);
- when the authorities had disregarded the fact that publicity of the searches of the applicant's business was likely to have an adverse effect on his work, personal reputation, and the reputation of the company that he owned and managed (*Buck v. Germany*);
- when the authorities had failed to investigate an applicant's claim that searches conducted by the police had been unlawful and had been a form of intimidation for having criticized the authorities;
- when the government had not provided any details about the reasons for the searches, did not have any record legitimizing them, and did not indicate the procedural significance of such actions;
- when the need to carry out searches for business documents in the applicant's home had not been justified (*Buck v. Germany*);
- when the number of policemen involved, their membership in a special interventions unit, and their being masked and armed with submachine guns left the applicant no choice other than to let them enter his premises. This was considered disproportionate and carried the risk of abuse of authority and violation of human dignity (*Gutsanovi v. Bulgaria*);
- when a disproportionate quantity of documents was seized (*Miaihle v. France*);
- when the authorities had not reacted in good time and correctly, or failed to conduct investigations into violations of the applicant's rights (*Novoseletskiy v. Ukraine*);
- when searches had been conducted without a search warrant even although the investigation had been opened several months before.

The Court has found to be a violation of Article 3 ill treatment in the course of inspections as well as the failure by authorities to duly investigate allegations concerning such treatment (*Kozinets v. Ukraine*). A breach of Article 13 (right to effective remedies) has been found where the national courts failed to review complaints concerning the retention of documents and other property seized during searches (*Smirnov v. Russia*).

Violations in connection with searches also include cases where documents and materials were seized for an excessive period of time, interfering with the applicant's peaceful enjoyment of possessions (Protocol No. 1), hindering his professional activities, and creating repercussions for the administration of justice (*Smirnov v. Russia*). The majority of Convention' violations in respect to searches and seizures are, however, connected to Article 8.

Other violations of applicants' rights have been found by the court in connection with the adoption of compulsory measures to obtain evidence in the context of administrative inquiries (*Funke v. France* and *Saunders v. UK*).

Considering the negative repercussions that illegal searches and seizures may have on an applicant's defence rights countries such as France have introduced a regime of nullities for search orders that are adopted in violation of the requirements set out in the Code of Criminal Procedure: search warrants must be given for specific searches and are the subject of written rulings, which specify the qualification of the offence for which the evidence is sought as well as the addresses of the premises in which the visits, searches and seizures may be carried out, they must be supported by reasons indicating matters of fact and law which show these operations to be necessary. These operations are carried out under the supervision of the judge who authorised them, and who may visit the scene to ensure that the legal requirements are respected.

As a further guarantee searches, except for cases of urgency, must be authorised by a judge specialised in the review of decisions adopted at the investigative stage: the judge for liberty and custody (706-89 CCP).

Protection of trade secrets and confidential information in the course of searches

The disclosure of information at the investigative stage may prejudice severely not only the investigation itself but also the individuals and companies subject to the searches. Protection of confidential information during searches and investigation is usually covered through provisions that ensure the confidentiality of the investigation as well as disciplinary and criminal provisions that target disclosure of confidential information and trade secrets. Further provisions stem from the application of the legislation on data protection and the protection of trade secrets.

In the case of *Craxi 2 v. Italy* the European Court held that the applicant's right to private life had been violated by the publication in the press of conversations that had been intercepted in the course of the criminal investigation against him. The Court noted that the conversations published in the press had been of a strictly private nature and had had little or no connection with the criminal charges brought against the applicant.

The Court concluded that the divulging of the conversations through the press had not been a direct consequence of any act by the public prosecutor, but had probably been the result of a malfunctioning of the registry or the press obtaining information from one of the parties to the proceedings or from their lawyers. It considered that the onus was on the Government to provide a plausible explanation as to how they had reached the media and that they had not done so. Nor had there been an inquiry into the circumstances in which journalists had had access to the transcripts. The Government had not fulfilled its obligation to secure Mr Craxi's right to respect for his private life.

In several countries provisions on trade secrets (technical or commercial information related to business, which is not generally known or easily accessible, which has economic value and whose disclosure to a competitor could cause prejudice to the owner's interests) have led to the criminalization not only of the behaviour of competitors or former employees who disclose such information but also of public officials. In these instances the fact that the secret had been apprehended in the exercise of official duties is often considered as an aggravating circumstance.

In Austria whoever discloses or exploits trade or business secrets is punished with up to six months imprisonment (up to one year if the conduct was committed with the goal of obtaining a pecuniary advantage or to cause harm to the owner) or monetary penalties, while spying out trade or business secrets for their exploitation by somebody else is punished with up to two years imprisonment or

monetary penalties⁸¹. In order to be held liable for trade secrets violation the offender must have acted at least with conditional intent while in Belgium and France the conduct may be punished even if the offender acted with negligence⁸².

In Germany whoever makes unauthorised acquisition of or secures trade or business secrets or uses them, can be punished with up to three years deprivation of liberty if he acted with the intent, in particular for the purpose of competition, personal gain, benefit to a third party or to cause damage to the owner of the secret. Similarly in Portugal whoever uses or discloses to third parties secrets that the offender knows by reason of his status, job or profession is punished with imprisonment of up to one year or a monetary fine⁸³.

Qualified offences have also been introduced in several countries when the revelation or use of confidential information is committed by a person acting in a particular capacity such as public official or civil servant.

Precautionary measures may be granted by judges and specific procedures have been introduced to access and seize documents containing confidential business information and held by the target of the search.

3.2.2.4 Criteria for the adoption of asset freezing and seizure orders: reasonable suspicion, risk of dissipation and proportionality

Normally the conditions for issuing an asset freezing order are:

- probability (a standard of evidence higher than mere suspicion) of the existence of a crime and of proceeds of crime (the amount);
- danger of disposal or hiding or destruction of proceeds of crimes by the accused.

According to the CARPO manual the proposal for asset freezing measures must include the results of the financial investigation:

- findings and evidence on the criminal offence and the accused;
- findings on the type and amount of criminal proceeds;
- findings on the property that can be seized and proposals as to which property can be seized and the person it belongs to;
- grounds for the legal conditions for the issue of an order (standard of evidence, danger of disposal).

According to the UNODC manual on confiscation:

When considering whether to issue a preservation or seizing order, the court will be conscious of the requirement that a crime has been committed that generated proceeds or that there is a link between the asset and criminal activity or the individual's lifestyle. The material filed in support of the application for the order must satisfy the standard of proof for an interim order (Para 190).

Since the preservation or seizing order is an interim measure in the sense that a criminal or civil trial has not yet commenced, the standard of proof required may be less stringent than the onus of proof in an actual trial. In addition, there may be a statutory precondition that criminal proceedings have commenced or are about to commence.

In *Arcuri v. Italy* the European Court stated that the freezing of criminal assets requires “sufficient circumstantial evidence... to show that the property concerned forms the proceeds from unlawful activities or their reinvestment”.

⁸¹ European Commission (April 2013) *Study on Trade Secrets and Confidential Business Information in the Internal Market*, available at: <http://ec.europa.eu/>

⁸² Ibid.

⁸³ Ibid.

In Italy the adoption of asset freezing orders involving companies is conditional on the existence of serious suspicion of the involvement of a company in a crime and the existence of a concrete risk that crimes similar to the ones under investigation will be committed.

In investigations concerning money laundering, the CoE Moneyval and the FATF have introduced the concept of “suspect operations” that enables state authorities to freeze and confiscate assets irrespective of the existence of underlying predicate offences as long as a suspect offence/ behaviour takes place.

Suspicious transactions are defined as transactions that organisations and individuals referred by the anti-money laundering regime consider particularly susceptible, by its nature or by its unusual character to the activities of the client, by the circumstances that surround or the quality of the people involved, to be related to money laundering or terrorist financing.

In Andorra, the criteria deemed as sufficient to consider a given operation as suspicious and warranting asset freezing order are established on the basis of technical communications of the financial investigation unit aimed at identifying transactions and individuals at risk as well as countries at higher risk of money laundering. Among such criteria the fact that a target individual is not physically present in the country for identification is considered a relevant risk factor as well as *relations de correspondant bancaire avec des entités étrangères*.

It should be noted that, according to the latest EU directive on money laundering (the fourth directive published on the 5th of February 2013), asset freezing orders must be proportionate according to the risk as assessed by each country. The directive has introduced a proportionality criterion in the fight against money laundering.

The respect of the proportionality principle also requires that a court ordering asset freezing should fix the duration of the measure.

In *Jouan v. Belgium* the prosecuting authorities in placed the applicant under judicial investigation on suspicion of money laundering and ordered the preventive attachment of his bank account. The applicant complained, under Article 6.1 (right to a fair trial) of the Convention, claiming that his bank account in Belgium had been blocked for an unreasonable length of time and that he had not had access to his case file.

The Court considered that the three-year period during which the applicant's bank account had been blocked exceeded a “reasonable time” and therefore held unanimously that there had been a violation of Article 6 of the Convention.

The UNODC model legislative provisions on terrorist financing provide that States may also consider setting time limits beyond which the freezing [seizing] order is automatically discontinued, for instance when formal proceedings against the person whose funds have been frozen [seized] have not been instituted. Such possibility would add an additional safeguard ensuring that persons affected by the freezing [seizing] order do not have to suffer the consequences of an excessively slow administration of justice.

The determination of time limits beyond which attachment orders should not extend is present in virtually all European countries. Slovenia amended its CCP as the lack of a provision on the duration of the asset freezing was considered to excessively interfere with the right to property. In Italy asset seizures should not last longer than five years.

Assessment of the type and amount of illegally acquired proceeds

According to the Explanatory memorandum on Article 2 of the CoE Convention (141), the expression “property the value of which corresponds to such proceeds” refers to the obligation to introduce

measures which enable Parties to execute value confiscation orders by satisfying the claims on any property, including property which is legally acquired. Value confiscation is, of course, still based on an assessment of the value of illegally acquired proceeds.

The CARPO training manual notes that the ways to establish amount and type of proceeds vary between EU states.

Appraisal of attached assets

A financial investigation allows the accurate appraisal of assets that may be attached, so that a balance with the right to a peaceful enjoyment of property is ensured.

According to the G8 “best practices for the freezing and administration of seized assets” seized property should be appraised to establish the market value of the asset at an appropriate time, such as the date of the forfeiture. States may wish to use qualified third parties for this purpose.

The UNODC manual on confiscation states that, since there may be a significant interval between seizure and confiscation, additional measures should be considered and implemented. One such measure is that the asset manager should obtain an expert opinion on the value of the seized asset.

Management of seized assets

According to the G8 “best practices for the freezing and administration of seized assets”, the value of seized assets must be preserved, strong controls over administration of seized assets must be in place, no single person can have full control over all aspects of seizure or must be fully accountable to a higher body.

Seized assets must be administered with transparency, administration should be verified annually by external auditors, and the findings of verification must be made available to the public. No person responsible for the seizure of assets should receive personal financial reward connected to the value of a seizure, nor should seized assets be used for personal purposes.

Use of seized assets by defendant or third party must be regulated by law. When administering the assets, the interests of the defendant should be taken into consideration.

In the *Novoseletskiy v. Ukraine* judgment the court held that the respondent state had violated the convention on account of its failure to investigate into the disappearance of property belonging to applicant.

In the case *Raimondo v. Italy* concerning allegations of violation of the right to property on account of damages to seized property the Court held that a degree of damage is inevitable when property is seized, and hence the real question is whether the damage suffered went beyond what is inevitable. If that is the case, then compensation will be required.

Pursuant to the FATF operational guidelines appropriate planning takes place prior to taking freezing or seizing action.

There are measures in place to:

- i. properly care for and preserve as far as practicable such property;
- ii. deal with the individual's and third party rights;
- iii. dispose of confiscated property;
- iv. keep appropriate records; and
- v. take responsibility for any damages to be paid, following legal action by an individual in respect of loss or damage to property.
- vi. Those responsible for managing (or overseeing the management of) property have the capacity to provide immediate support and advice to law enforcement at all times in relation

- to freezing and seizure, including advising on and subsequently handling all practical issues in relation to freezing and seizure of property.
- vii. Those responsible for managing the property have sufficient expertise to manage any type of property.

Good practices: Seizure of companies' assets (companies under influence of mafia and in the context of corporate liability) in Italy

When the asset seizure may involve corporate assets the law provides different criteria based on the extent of the control an individual under investigation has over a company: if he only owns some shares, normally only the shares and not the whole company will be subject to seizure.

In the case the individual under investigation is the majority shareholder of a company only his shares can be seized, as seizing the whole company would interfere with the right of third parties.

In Italy, the legislator has specifically introduced the possibility to subject to asset seizure entire companies (law 109/1996).

The seizure of a whole company may take place in the case the person under investigation is the only shareholder in a limited liability company or has effective complete control over the company to the extent that it he uses the company as if it was his own.

The seizure of an entire company will normally take place in the case of sham companies the only goal of which is to hide the assets of an individual. It is considered sufficient to seize the shares only if the company is effectively engaged in business activities. It is also usually preferred to seize only the shares in respect of corporations, while in regards of partnerships it will be possible to seize the entire company if the individual under investigation exerts a direct influence over the partnership.

A company is considered unlawful if its activity, object or goal is contrary to peremptory norms (*norme imperative*), public order or public decency. So usually company will be considered as unlawful if its only goal is to engage in money laundering, if produces or sells goods and services, which production and sale are not allowed by law or are contrary to public decency. An example of illicit company is a bank that operates notwithstanding the absence of the authorisation to engage in banking activities. In order to be considered as illicit a company must repeatedly engage in the prohibited activity.

The Italian legislation has also specifically regulated the asset seizure of the so-called mafia-company. A mafia company differs from an unlawful company as while it may be formally lawful and engaged in legal activities, it is usually controlled and/or funded by mafia type organisations that invest in it capitals of unlawful origin or use unlawful competition schemes to give it comparative advantages for example by manipulating public procurement procedures. The provisions concerning the asset seizure of mafia companies is based on the need to fight organised crime that over the years has increasingly and consistently reinvested proceeds of crimes into lawful companies, use such investment to obtain the hiring by the company of individuals who have connections to the mafia who then control and steer the entrepreneurial activities of the company.

According to the Italian legislation the tribunal who orders the asset seizure also appoints the judge charged with the control and overview over the asset seizure. The tribunal also appoints a judiciary administrator (*amministratore giudiziario*). Judiciary administrators are chosen from a list in the national register of judiciary administrators and must specialise in business administration. They are considered as public officials and are charged with the conservation and management of the seized assets throughout the entire proceedings. Asset seizures cannot last less than one year and longer than five years.

The administrator appointment can be withdrawn at any time in case of incapacity or severe irregularities. Within 30 days from his appointment the judiciary administrator must submit to the

judge charged with supervising the management of the seized assets a report on the assets and is obliged to register all the measures he adopts in regards of the seized assets on a register/book.

In case it is not possible to ensure the continuation of the business or its resumption, the tribunal can, upon having heard the prosecutor and the judiciary administrator close the company and proceed to its liquidation. The liquidation procedure is regulated in detail and supervised by a judge in order to ensure that the rights of creditors are respected. In particular employees of the company are given priority over all the other creditors.

The law on corporate liability 231/2001 has further introduced the possibility of adopting preliminary measures against companies for a predetermined number of crimes. Such measures include the suspension of licenses and permits related to the crime, temporary prohibition to contract with the public authorities, the suspension of aids and contributions or services from the state or the prohibition to advertise goods or services.

Such measures can be applied only in specific circumstances such as when the company has derived a considerable benefit from the crime or when the crimes have been repeated and a judicial decision has already been adopted in respect of previous crime. Such measures can last between three months and two years.

The court, in instances when a suspension of the activity may stem from the adoption of precautionary measures, can appoint a judicial administrator who can ensure the continuation of the activity when the company provides public services or when the interruption of the activity may have negative impact on employment. The judicial administrator's activity is focused on the adoption of measures ensuring that internal audit mechanisms prevent future violations while he cannot adopt extraordinary management measures

In Spain the seizure and management of property is partially covered by Article 129 of the Penal Code. Closure or suspension of company activities takes place only if the company is directly involved in illegal activity. In rare cases, the judge may appoint an administrator for a company.

3.2.2.5 *Judicial remedies against asset freezing and asset seizure orders*

With regard to the applicability of Article 6 § 1 under its civil head, the Court reiterated its consistent case-law to the effect that Article 6 does not apply to proceedings relating to interim orders or other provisional measures adopted prior to the proceedings on the merits, as such measures cannot, as a general rule, be regarded as involving the determination of civil rights and obligations (see, among other authorities, *Jaffredou v. France* (dec.), no. 39843/98, 15 December 1998; *Kress v. France* (dec.), no. 39594/98, 29 February 2000; *APIS a.s. v. Slovakia* (dec.), no. 39754/98, 13 January 2000; *Starikow v. Germany* (dec.), no. 23395/02, 10 April 2003; and *Libert v. Belgium* (dec.), no. 44734/98, 8 July 2004).

Only exceptionally has the Court accepted the applicability of Article 6 § 1 to an interim decision (see *Markass Car Hire Ltd v. Cyprus* (dec.), no. 51591/99, 23 October 2001; *Air Canada*, cited above, §§ 15 and 56; and *Zlínasat, spol. s r.o., v. Bulgaria*, no. 57785/00, § 72, 15 June 2006).

In any case there should be means for those with a legal interest in seized property to apply to the court to modify a restraining order or to release the property subject to adequate controls as the inability to challenge asset freezing orders could engage Article 13 of the European Convention

According to the UNODC Model provisions on money laundering:

The freezing [seizing] order shall be revoked at any time by the [competent authority] at the request of the [public prosecutor's office/ other competent authority], or of any other person claiming to be affected by such measures, when there are no longer any reasonable grounds to believe that the frozen

[seized] funds have been used or allocated for the purpose of committing an offence related to terrorism.

Right to ask for a review of that measure at “any time”: A review might be requested for the purpose of having the measures modified or discontinued. This may be the case when, for instance, a person can produce new evidence that was not available at the time of the hearing when the measure was first imposed (Article 35 Revocation of provisional measures).

Domestic law and policy should clearly set forth the rights of bona fide third parties in relation to property subject to a restraining order.

This may include allowing a person to carry on a legitimate trade or business that would otherwise be subject to seizure or allowing tenants to continue to occupy commercial real estate (G8 best practices for the freezing and administration of seized assets).

Pursuant to the Council Framework Decision 2003/577/JHA of 22 July 2003 on the execution in the European Union of orders freezing property or evidence Member States must ensure that any interested party, including third parties, have legal remedies without suspensive effect against a freezing order.

According to the World Bank asset recovery handbook where a third party holds an interest or share in a business or investment venture with a target, practitioners will want to ensure that the interest is held bona fide and that the interest concerned is not beneficially owned or controlled by a target. If confirmed, it is important to draft the order in such a way that the third-party interests are not restrained or seized. In such cases, a restraint order can require that the business continue under normal processes, but with strict reporting requirements to the court and oversight by the asset manager, thus permitting uninvolved third parties to participate in and benefit from the business, but escrowing any benefits due to the target and preventing any involvement by the target in the running of the business

3.2.2.6 Standards for confiscation: lawfulness, proportionality, reversal of the burden of proof

Confiscation must be lawful and provided by law, which requires the existence of a clear and precise legal provision adopted in accordance with the rule of law (*Adzhigovich v. Russia* and *Sun v. Russia*).

Besides this, the benefits that can be confiscated must be linked to the offences that form the basis of the defendant’s conviction. In addition, the assets should be limited to those owned by the defendant, although this issue is often resolved through presumptions and broad definitions of “ownership” to include assets that are held, controlled, or gifted by the defendant.

The term “benefits” is usually broadly defined to include the full value of cash or non-cash benefits received by a defendant (or a third party at the defendant’s direction) directly or indirectly as a result of the offence.

Benefits will usually cover more than rewards of a financial nature. Some examples include:

- The value of money or assets actually received as the result of committing an offence (for example, the revenues from an initial contract obtained by bribery);
- The value of assets derived or realized (by either the defendant or a third party at the direction of the defendant) directly or indirectly from the offence (for example, supplemental work obtained in the context of that same contract); and
- The value of benefits, services or advantages accrued (to the defendant or a third party at the direction of the defendant) directly or indirectly as a result of the offence (for example, the possibility of obtaining future contracts based on the experience gained through an initial contract obtained through bribery).

In *Geerings v. Netherlands* the applicant complained that the confiscation order imposed upon him infringed his right to be presumed innocent under Article 6(2) since it was based on a judicial finding that he had derived advantages from offences for which he had been acquitted in the substantive criminal proceedings that had been brought against him. The ECtHR agreed, stating that ‘confiscation’ following on from a conviction is a measure inappropriate to assets which are not known to have been in the possession of the person affected.

In the *Jucys* case the ECtHR confirmed that, as a general rule, confiscation laws are generally held to be proportionate, but where they impose an excessive burden on the citizen or where high value assets are the subject of an order and there is a tenuous or weak connection to the criminal conduct (usually in relation to instrumentalities), the courts have found such confiscation in rem actions to be disproportionate.

In France, asset confiscation has long been an ultimate penalty, imposed only for the worst of crimes. In some Member States, the right to own a house is put above other laws and the confiscation of a sole domicile is forbidden, regardless of the origin of the funds that were used to acquire it.

The ECtHR has established that presumption of innocence at the stage of asset freezing does not apply, however other guarantees under Article 6 apply.

The assets subject to provisional measures will be those needed to satisfy the eventual confiscation order. Applications for provisional measures should be carefully crafted to correspond to the confiscation sanction or sanctions (because more than one can be pursued) that might operate against restrained or seized assets.

Ensuring that the appropriate assets are subject to provisional measures will depend on the confiscation system in place (that is, whether it is a property-based or value-based system).

Adequate procedural safeguards must, however, be in place to ensure that the accused can effectively rebut such presumptions (*Pham Hoang v. France* [1992]) and prove that assets are not the proceeds of crime. Some limits are also needed with regard to the scope of application of extended confiscation - it cannot, for example, apply to assets connected with an offence for which the defendant has been acquitted (*Geerings v. Netherlands* [2007]). Issues may also arise with regard to Article 7 if the regime is applied retroactively to assets acquired prior to its introduction.

In *Phillips v. UK* the ECtHR reiterated that the principle according to which the prosecution must bear the burden of proof is not a rigid one – persuasive presumptions are acceptable as long as states act within reasonable limits. Crucial to the case was the fact that the national judge had discretion as to whether to apply the assumptions and that he could avoid doing so if it were to cause serious injustice. Hence there was no violation of Article 6. All in all, it seems that the compatibility of statutory assumptions typical of extended confiscation regimes with Article 6(1) and (2) will be assessed on a case-by-case basis and will pass muster if reasonably applied and if adequate procedural safeguards are injected into the process.

There are a variety of interpretations as to the burden of proof provisions. While in some countries the burden of proof is reversed, it can also be shared (e.g. Belgium).

In some countries, a reversed burden can be applied for specified crimes (for example, drugs and organised crime in Italy).

In some countries the reversal of *onus* is at the discretion of the court.

In some countries (such as the Czech Republic), not only is a reversed burden of proof unavailable, but a particularly high standard of proof has to be applied in cases of asset seizure.

Criminal confiscation in the UK, as set out in the Proceeds of Crime Act, can be divided into two categories: that of ‘general criminal conduct’ (so-called lifestyle offences, explored further below) and ‘particular criminal conduct’. Such division has an impact on the reversal of the burden of proof.

When making a Confiscation Order the court must make a judgment on whether the defendant has lived a “criminal lifestyle”, and if so whether they had gained financially from that lifestyle (see below for further details).

Pursuant to the Proceeds of Crime Act if the court finds that the defendant has a criminal lifestyle, then unless there is a serious risk of injustice, it will make the following four assumptions:

1. any property transferred to the defendant at any time after the relevant day was obtained by him as a result of his general criminal conduct and at the earliest time he or she appears to have held it; and
2. any property held by the defendant at any time after the date of conviction was obtained by him or her as a result of his or her general criminal conduct or at the earliest time he or she appears to have held it; and
3. any expenditure incurred by the defendant at any time after the relevant day was met from property obtained by him or her as a result of his or her general criminal conduct, and
4. for the purpose of valuing any property obtained or assumed to have been obtained by the defendant, he or she obtained it free of any other interests in it.

If it is decided that the defendant does not have a ‘criminal lifestyle’ the court must decide whether he has benefited from his ‘particular criminal conduct’. The amount to be confiscated is based on an assessment of the financial benefit shown to accrue to the defendant from the conduct. The standard of proof required in this instance was that required in civil cases (a “balance of probabilities”) as opposed to the usual criminal benchmark of “beyond reasonable doubt”.

3.2.2.7 Standards for confiscation of assets in the possession of third parties

Divesting assets to third parties is a common tactic for defeating the authorities. A confiscation regime is thus incomplete without some means of application to third parties.

Broadly, there are two routes. One is to base confiscation upon a separate crime (e.g. a ‘fencing’ or money-laundering charge), in which case there is no longer a third party. The other, known as third-party confiscation, is to allow confiscation orders to extend to third parties.

A system for third-party recovery must define the circumstances in which the claim of the third party outweighs the public interest in confiscating and recovering criminal assets. The most important factor here is whether the third party is bona fide. If not, they do not have the same moral entitlement to the asset. This may be obvious where the person knew, or suspected, that an asset was the proceeds of crime, but the issue becomes less clear cut where it is necessary to apply an objective standard – that is, where their suspicions were not aroused in circumstances where those of a reasonable person would have been. Another relevant factor is the amount, if anything, paid for the asset, as this bears upon the strength of the third party’s moral claim vis-à-vis the deprived victim (UNODC manual on international cooperation for the purposes of confiscation of proceeds of crime).

In linking a target to an asset or account held in the name of an associate, close relative, or company, it is helpful to look into the transactional activity surrounding the asset and to consider a number of factors, including:

- the amount paid for the asset (market value), including whether the mortgage responsibility was transferred with the title;
- the source of funds used to purchase the asset; the person paying the expenses and outgoings associated with the asset;

- the capacity or resources of the owner of the asset to purchase or maintain the asset; and
- the person occupying, possessing, or controlling the asset.

These questions can lead to the accumulation of evidence, circumstantial or otherwise, that will permit a court to draw the inference that assets owned by a third party are actually beneficially owned or controlled by the target and therefore (if the law permits) subject to restraint or seizure and eventual confiscation (World Bank asset recovery handbook).

Partial interests in assets

A target will often hold a partial interest in or a share of an asset, business entity, or investment. Unless it is alleged that the remaining interests are beneficially owned or controlled by the target, it is important to ensure that restraint is limited to the target's interest in the asset (UNODC manual on international cooperation for the purposes of confiscation of proceeds of crime).

In France third party seizures are possible, and have been facilitated with the introduction in February 2006 of the criminalisation of the inability to justify the origin of one's assets (non-justification de ressources). This has provided a much easier way to pursue criminal assets transferred to another person. There are some other legal possibilities for third party seizures, but this new legislation is currently being used in preference to other approaches.

3.2.3 Conclusions

Seizure of property is a necessary tool to ensure gathering of evidence in criminal investigations. However, this measure can be misused in a number of principal ways, such as:

- Arbitrary or disproportionate seizure;
- Failing to preserve the integrity of the seized property or to otherwise handle it properly.

A well regulated system of identification, freezing, management and confiscation of proceeds of crime responds both to the needs for an effective and efficient investigation and the need for protection of property rights of those individuals or legal persons affected by an investigation. Such regulation is even more important in cases when companies are affected and unfairly prejudiced by asset seizing and confiscation measures.

When investigating economic crimes it is extremely important that investigations are carried out by investigators and prosecutors who have received specialised training in dealing with the economic aspects of crimes. Such investigations may be supported by financial investigations carried out by specialised units who can provide reliable expert opinion on the financial and economic aspects of a case. Another important aspect is that these cases are decided by specialised courts or judges who have undergone specific training. For example in France the Code of Criminal Procedure has introduced the exclusive jurisdiction of certain district courts and investigative authorities specialising in the investigation and prosecution of economic and financial matters. Judges deciding over these matters must have at least four years of professional experience.

Measures have been widely introduced to ensure that searches do not lead to disproportionate and indiscriminate seizure of documents or that trade secrets or confidential information are affected. For example in Norway when objections are raised in respect of documents that may disclose confidential information the documents are sealed and subsequently opened and reviewed in the presence of the judge and the affected individual.

International tools also contain a detailed regulation of standards for asset freezing and seizure orders: in order for a judge to allow the attachment of assets it should be established that it is probable that a crime has taken place, that the assets to attach are proceeds of crime and there is danger of disposal or destruction of the assets.

Prosecutors applying for an attachment order are usually required to submit the following information:

- findings and evidence on the criminal offence and the accused;
- findings on the type and amount of criminal proceeds;
- findings on the property that can be seized and proposals as to which property can be seized and the person it belongs to; and
- grounds for the legal conditions for the issue of an order (standard of evidence, danger of disposal).

It is notable that consideration of the need to protect productive activities, certain countries have introduced a higher standard of evidence (grave suspicion of the commission of a crime) when asset freezing measures are to be adopted in respect of companies.

Detailed regulations and mechanisms have also been introduced to ensure that the type and amount of proceeds of crime are assessed, that the attached assets are appraised at the very outset of the forfeiture and that the seized assets are managed and disposed of in a transparent and efficient manner ensuring that proper controls and mechanisms for compensation are available.

3.3 Preclusive effect of judicial decisions in the criminal field, incriminating statements by co-accused

One example of the way in which the preclusive effects of judgments in criminal cases may be misused is when the statements by, or conviction of, a single defendant is employed in order to convict defendants in a related (but separate) case. This may be done by targeting a more vulnerable defendant and obtaining his/her plea of guilty, or otherwise convicting him/her first, and then using the conviction to try the other defendants. The process against the other defendants then skips the proper assessment and cross-examination of evidence through the adversarial process (especially when the first of the defendants has been convicted in a simplified procedure).⁸⁴

3.3.1 The Russian Federation

Pursuant to Article 90 of the Code of Criminal Procedure the “circumstances established by a sentence which has come into legal force or by other effective court decision passed within the framework of civil, arbitration or administrative court proceedings, shall be recognised by a court, prosecutor, investigator or inquirer without any additional verification. With this, such sentence or decision may not prejudice the guilt of the persons, who have not taken part in the criminal case under consideration earlier”.

This provision significantly differs from similar provisions of other CoE member states in that, although it expressly mentions that the guilt of third parties may not be prejudged by a sentence, it nevertheless allows the application of preclusive effects of criminal judicial decisions in respect of other criminal proceedings beyond the application of the *non bis in idem* principle.

In its rulings the Constitutional Court has stated that the preclusive effects of final judgements cannot be absolute and are subjects to certain statutory limits. In a number of Decisions (from May 11, 2005 N 5-N from 2 February 5, 2007-N and from March 17, 2009 N 5-N), the Court has ruled that it is only possible to overcome the finality of a judicial decision entered into legal force if a new, or newly discovered, fact constitutes undeniable evidence of a miscarriage of justice.

The lack of sufficient safeguards against the abuse of preclusive effects of criminal judicial decisions was reported in the explanatory memorandum to the CoE report *Allegations of politically motivated abuses of the criminal justice system in Council of Europe member states*: “[a]lso, the prosecution

⁸⁴ A Krevetnikov (April 2013) *The Basmany court prejudice - the queen of evidence*, [В басманных судах преюдиция - царица доказательств] BBC, available at www.bbc.co.uk/

tactics consisting of the artificial separation of cases against different persons accused of being involved in the same incriminated acts are still very much in use... These tactics are designed to circumvent the privilege against self-incrimination as well as the protection afforded by law to the communication between lawyers and their clients and finally to create facts or “precedents” that can be “imported” into later trials against other alleged participants without proper participation of the defence in the later trial. Such tactics appear to undermine the right to a fair trial (Article 6 ECHR).⁸⁵ Notwithstanding the limitations introduced by the second paragraph of Article 90 of the Code of Criminal Procedure it appears that the defence rights of co-accused in separated criminal proceedings are considerably weakened by the privileged value attributed to facts established in previous criminal proceedings.

For example: in a decision of the 25th of July 2012, N 5-O12-47, the Judicial division for criminal cases of the Supreme Court ruled on a criminal case filed by an entrepreneur convicted of fraud. The applicant complained against the decision of the lower courts which based the conviction on the previous sentences against co-accused. In rejecting the appeal, the Supreme Court held that, although the sentences against the co-accused had been adopted following a plea bargain, they had been based on the court’s assessment that the charges were founded and supported by evidence. For this reason the court could consider them as proved against the applicant without further verification.⁸⁶ As a result the applicant was effectively unable to submit any evidence to the contrary.

In another recent case, following a plea bargain with its general director, it was established that the company Stroimontazh LLC had engaged in illegal entrepreneurship under Article 171 of the Criminal Code. This sentence was then used against the company’s contractors as non-rebuttable evidence that all the contracts concluded with Stroimontazh LLC were null and void and hence all of its contractors had received unlawful tax benefits. The *arbitrazh* courts seized by one of the contractors, the company Izmailovo LLC, refused to allow evidence to be submitted to the effect that Izmailovo had effectively obtained services from Stroimontzh LLC.⁸⁷

3.3.2 International standards: ECHR

Limits on preclusive effects of judicial decisions

In the *Gozutoc* and *Brugge* cases (Cases C 187/01 and C385/01), the Advocate General of the European Court of Justice Ruiz Jarabo stated that three circumstances must be present to give preclusive effect to a judicial decision: the same facts; the same parties; and the same legal principle being protected.

The Advocate general also denied that judicial decisions based on a plea bargain or a guilty plea although admissible⁸⁸, may have preclusive effects in respect of subsequent proceedings affecting the

⁸⁵ Parliamentary Assembly of the Council of Europe, Report Doc. 11993 (07 August 2009) "*Allegations of politically-motivated abuses of the criminal justice system in Council of Europe member states*", Committee on Legal Affairs and Human Rights, Rapporteur: Ms Sabine Leutheusser-Schnarrenberger, available at <http://assembly.coe.int/>

⁸⁶ “Судебная коллегия не может согласиться и с доводами о неправомерности использования судом в качестве доказательств приговоров в отношении указанных лиц, вступивших в законную силу. Данные приговоры хотя и постановлены в особом порядке, предусмотренном главой 40.1 УПК РФ, однако основаны на выводах судов о том, что обвинение, с которым согласились подсудимые, является обоснованным и подтверждается доказательствами, собранными по уголовному делу; содержат описание преступных деяний, обстоятельства которых в силу ст. 90 УПК РФ признаются в последующем без дополнительной проверки”.

⁸⁷ *Decision of the Court of cassation on 12 September 2012 [Постановление (определение) суда кассационной инстанции: Оставить решение (определение) суда первой инстанции и постановление суда апелляционной инстанции без изменения, а кассационную жалобу - без уд]* available at <https://rospravosudie.com/>

⁸⁸ “The freedom to accept or reject the settlement is fundamental. It may prima facie be doubted whether such freedom exists since, de facto, the accused has to accept the offer made by the Public Prosecutor’s Office if he wishes to escape criminal proceedings. However, that fact does not invalidate his consent, since the threat of bringing a particular action is not objectionable if the means used and the objectives pursued are lawful.

From the moment the accused accepts the public representative’s proposal and fulfils the conditions imposed, the State has given its final response to the unlawful conduct, so that a person who settles and accepts the agreement, just as an accused whose case is disposed of in a non-appealable judgment, is entitled to expect that there shall be no looking back, that the content of the settlement shall remain firm and that he will not be troubled in the future in respect of the same acts.

same individual: “[t]his special operation of the decision only goes as far as the point at which the Public Prosecutor’s Office may settle, that is to say, the criminal action, but it is not capable of affecting actions which, like the civil action arising out of every criminal infraction, may be brought by the victim or, more generically, the injured party.”

In the case of *Klouvi v. France* the ECtHR addressed a similar issue, albeit concerning the same facts but with different individuals who had been involved in connected criminal proceedings. The applicant, who had lodged a criminal complaint against her former line manager alleging rape and sexual harassment, had been convicted for making a false accusation after a final ruling that there was no case to answer for lack of sufficient evidence. The French judge based his decision on a provision of the Criminal Code which provided that a final ruling that there was no case to answer automatically meant that the complainant’s accusations were deemed to have been false. The ECtHR held that this provision was in violation of the applicant’s right to be presumed innocent.

Incriminating statements by co-accused and the right to a fair trial

In general, the presumption of innocence entails that the prosecution must prove the accused’s guilt beyond reasonable doubt. The ECtHR holds that “the burden of proof is on the prosecution and any doubt should benefit the accused. It also follows that it is for the prosecution [...] to adduce sufficient evidence to convict him (*Salabiaku v. France*, Para 28).

The presumption of innocence implies a right to be treated in accordance with this principle. It is, therefore, a duty of all public authorities to refrain from prejudging the outcome of a trial (General Comment No. 13 (Article 14), in UN Compilation of General Comments, p. 124, Para. 7).

Article 6 (2) of the ECHR does not prohibit rules, which transfer the burden of proof to the accused to establish his/her defence, if the overall burden of establishing guilt remains with the prosecution. Nor does Article 6 (2) necessarily prohibit presumptions of law or fact, but any rule which shifts the burden of proof, or which applies a presumption operating against the accused, must be confined within “reasonable limits which take into account the importance of what is at stake and maintain the rights of the defence” (*Salabiaku v. France*).

In regard to this specific case, the ECtHR has stated that the confession of one co-defendant may not be used as the foundation of a guilty verdict for another co-defendant who has not confessed (*Vladimir Romanov v. Russia*, §§97-106).⁸⁹

Overall Article 6 requires that an accused be given the chance to cross examine key witnesses against him before their statements may be taken into consideration by the courts when deciding guilt.⁹⁰ Until a witness has been cross-examined by an accused, his statements cannot be used to prove his guilt.⁹¹

Written depositions retracted by a witness at trial may also be considered as insufficiently reliable to support an accusation where the key witness was not properly questioned (*Orhan Çağan*, §§31-43).

That is to say, the settlement is binding and, once it has been executed, constitutes the State’s final word on the matter. Enforceability and *res judicata* are the two factors which characterise any legal decision disposing of an action”.

⁸⁹ Co-accused, under the Convention, can, under certain conditions, be assimilated to witnesses: the word witness itself in Article 6 §3d has a fully autonomous meaning and applies not only to persons called to give evidence at trial. It includes: authors of statements recorded pre-trial and read out in court (*Kostovski v. the Netherlands*, §§38-45); depositions of the co-accused (*Luca v. Italy*, §§38-45); and persons having specific status, such as experts (*Boenisch, Brandstetter*).

⁹⁰ A key prosecution witness – whose evidence is used in its entirety, or to a decisive or crucial degree, to ground a conviction – can be required to be called as of right under Article 6 §3d (*Vidal; Doorson*).

A witness may also become key if his evidence is able only to confirm or counter a particular defence chosen by the applicant, such as an entrapment defence (*Ramanauskas*).

⁹¹ In the case *D.V. v. Romania* the court held that a violation of the applicant’s defence rights had taken place on account of the fact that his conviction had been based mainly on a statement by the victim, which had not been read out to him at any point during the proceedings. Nor had any other steps been taken to enable him to challenge the victim’s statements and her credibility.

A witness must be questioned, either at trial or earlier, with the participation of the defence, for example, at a face-to-face confrontation at the pre-trial stage (*Isgrò*, §§30-37), or in a previous set of related proceedings (*Klimentyev*, §§124-127).⁹²

3.3.3 Council of Europe member states

Taking the member states of the CoE as whole no preclusive effects are given to criminal judicial decisions in respect of connected criminal proceedings and the effect of criminal proceedings in respect of subsequent civil proceedings are usually limited to civil proceedings for compensation of damages between the same parties to the criminal proceedings. Facts that have been established in civil proceedings do not usually have preclusive effect in respect of subsequent criminal proceedings due to the different standard of proof – while criminal proceedings require proof beyond any reasonable doubt, judicial decisions in civil proceedings are usually based on a balance of probability. There are some minor exceptions to this rule are concerning civil decisions to determine the family status or citizenship.

Detailed regulations have been introduced in respect of the admissibility of statements by co-accused which have become the object of specific legislative discipline. Such legislative provisions entail a limitation of the free appreciation by a court of said evidence. This regulation is justified by the fact that, differently from witnesses, co-accused are not required to give statements under oath, that they have the right to remain silent, that their statements can only be used as evidence against themselves, and that false statements bear no responsibility. A co-accused will have incentives to shift the blame onto other co-accused to lessen his own responsibility.

Belgium

In Belgium the preclusive effects of criminal judicial decisions have been increasingly limited by the law and the courts. Preclusive effects will only affect those facts of a decision which have been examined in an adversarial procedure.⁹³ No preclusive effects are granted to sentences adopted following simplified proceedings or guilty pleas where the evidence has not been so examined.

Even parties to subsequent civil proceedings who did not participate in previous criminal proceedings are allowed to raise an exception to the use of preclusive effects against them on the basis of Article 6 of the ECHR. Preclusive effects are limited to issues that have been effectively litigated and discussed in an adversarial trial.⁹⁴

Italy

A judicial decision adopted in criminal cases only has a preclusive effect on subsequent civil and administrative cases against the same individuals who participated in the criminal trial. Convictions do not have a prejudicial effect on other criminal cases because the guilt of an individual should be proven beyond reasonable doubt. A conviction will not even have prejudicial effect against the same parties in subsequent civil proceedings if the conviction was adopted following an out of court settlement (*dosudebnoe soglashenie* in Russian). Article 651 of the CCP strongly limits the applicability of the prejudicial value as to whether a fact took place and whether such a fact constituted a crime and whether the defendant committed it.

According to Article 651 of the CCP, a conviction that entered into legal force following an “ordinary trial” (i.e. a trial where evidence has been examined), but not a pre-trial settlement, has preclusive effect for civil and administrative proceedings (for compensation of damages) in determining: whether a fact has happened; whether this fact constituted a crime; and whether the defendant committed it.

⁹² A pre-trial challenge of prosecution witnesses by the defence will not be sufficient to fully guarantee defence rights where it was not followed by proper procedural safeguards (*Melnikov v. Russia*, §§70-84), or where the witnesses subsequently changed their position (*Orhan Çağan v. Turkey*; §§31-43; *Vladimir Romanov v. Russia*, §§97-106).

⁹³ “*L’autorité de la chose jugée, le principe dispositif et le principe du contradictoire*”, 8 octobre 2001, R.C.J.B., 2002, p. 236-254, spéc. p. 241 et s.

⁹⁴ H.-D. bosly, D. Vandermeersch, M.-A. Beernaert, *Procédure pénale*, La Charte, 5ème éd., 2008, p. 337.

Article 238 bis of the Code of Criminal Proceedings expressly foresees the possibility of admitting as evidence previous judicial decisions, including sentences. This provision specifies, however, that such decisions are subject to the free assessment of the judge based on his innermost conviction. The facts therein ascertained must be corroborated by other evidence and cannot be used to avoid the application of the specific evidentiary regime concerning declarations of co-accused as regulated in Article 187 of the Code of Criminal Proceedings (concerning the admissibility and evidentiary value of co-accused statements).

In several decisions the Italian Supreme Court has clarified the impact of this article: in Cass. n. 12595/1998, the Court held that the fact that some individuals had been acquitted did not entail any consequence in terms of privileged evidentiary value in subsequent criminal proceedings against co-accused of the same crime as neither the facts therein established, nor the assessment of those facts indicated in the motivation, could bind the judge who should maintain his autonomy and freedom in the evaluation of the evidence.

In Cass. n. 5513/1996, the court held that the fact that an individual has been acquitted of a crime of which he had been accused does not automatically entail that the person who accused him is liable for slander as the competent court will have to autonomously and freely assess the facts again. The court underlined that the Italian Code of Criminal Proceedings does not admit that criminal judicial decisions have preclusive effect in respect of subsequent criminal proceedings as these effects are limited to subsequent civil, administrative and disciplinary proceedings. The court held that, in order to respect the right to an adversarial trial, it must verify whether the facts contained in the decisions correspond to the truth (Cass. n. 727/1995).

The Code of Criminal Proceedings contains a remedy, as an *extrema ratio*, in cases of conflicting judicial decisions. Pursuant to Article 630 it is possible to review a final judicial decision, not only when new circumstances are discovered, or when it is discovered that forgery of evidence took place, but also when the facts that have been established as basis of the decision (*fatti stabiliti a fondamento della sentenza o del decreto penale di condanna*) are incompatible with other facts declared as proven in another final judicial decision (*non possono conciliarsi con quelli stabiliti in un'altra sentenza penale irrevocabile*). Such formulation clearly restricts the categories of incompatible facts as a review will usually be possible only if one decision stated that a certain (criminal) event has taken place, while the other states that it did not.

The CCP also includes a very detailed regulation of the admissibility of co-accused statements irrespective of whether they have been made in previous trials and considered as proven in said trials.

The reform of constitutional and legislative regulation of the admissibility and assessment of co-accused statements against an individual was spurred by the ECHR decision in the *Luca* case (33354/96) wherein Italy was found in violation of the Convention on account of the lack of legal guarantees that an accused could cross examine, either during the investigation or at trial, co-accused who had made incriminating statements against him.

Following judgements of the European court the regulation of admissibility and evidentiary value of co-accused statements is now as follows:

The guilt of an accused cannot be based on incriminating statements of witnesses and co-accused who wilfully refused to be cross examined by the accused⁹⁵

The examination of witnesses should extend to their interests *vis-à-vis* the accused and other witnesses to evaluate their credibility.⁹⁶

⁹⁵ Article 111 of the Constitution

⁹⁶ Article 194 of the CCP

A co-accused of the same crime is, as a general rule, prohibited from becoming a witness against the accused.⁹⁷ There is an exception to this rule if: a judicial decision has entered into legal force against the co-accused, then he can be called as witness in the trial against an accused; or where the co-accused has not yet been convicted with a final judicial decision, he can be summoned as witness unless he is informed that he will become criminally liable for false testimony pursuant to Article 64.

An accused has the right to remain silent and any statements may be used against him. If he gives statements against other people then he will be considered as a witness and subject to criminal responsibility for any false testimony.⁹⁸

Co-accused who have been tried in previous processes cannot be obliged to give statements on facts if, in the criminal proceedings against them, they had denied their or were convicted.

A questioning of an individual who is in pre-trial detention must be audio or video recorded otherwise it will not be admissible.

A co-accused can be examined upon the request of the parties to a criminal case but must be assisted by a lawyer and has the right to remain silent.⁹⁹

There is also a general prohibition on reading and using in court statements gathered by the investigators during the preliminary investigation unless the law specifically allows it.¹⁰⁰ This rule is based on the principle that all evidence must be formed at trial.

Declarations made out of court can be read at trial only after the person who made such declarations has been questioned at trial.¹⁰¹

Minutes of other criminal proceedings can be used only against defendants whose lawyers had participated in the taking of the minutes.¹⁰²

Declarations of co-accused cannot *per se* be sufficient to convict a person but must be assessed together with other evidence supporting them. If the accused agrees to these minutes being read in court he has the right to cross examine the witnesses who gave them.¹⁰³

Declarations of co-accused can be used for the purpose of a judicial decision only if there are other elements that confirm their credibility.

The CCP also regulates in detail the evidentiary value of different type of evidence.

Evidence that has only limited value and must be supported by other evidence includes: statements of co-accused (especially when given outside of a court), and judicial decisions entered into legal force.

Judicial decisions entered into legal force can be used only to assess the credibility of witnesses.¹⁰⁴

⁹⁷ Article 197 of the CCP

⁹⁸ Article 64 of the CCP

⁹⁹ Article 210 of the CCP

¹⁰⁰ Article 514 of the CCP

¹⁰¹ Article 511.2 of the CCP

¹⁰² Article 238.2 of the CCP

¹⁰³ Article 192.3 of the CCP

¹⁰⁴ Articles 236.2 and 238 bis of the CCP

Spain

In Spain constitutional court decisions concerning incriminating evidence given by co-accused have focused on whether such evidence is *per se* sufficient to convict an individual or whether it must be supported by other evidence.

The Spanish constitutional court in its decision of the 12th of May 1986 has excluded the evidentiary value of such statements in two circumstances: when the statements were given with the aim of excluding or reducing one's own responsibility; and when there is reason to believe that the co-accused was driven by reasons of hatred, the instructions of a third person, or inducement by the prosecution in exchange for better treatment (2446/1986 RJA).

A Supreme Court decision of the 26 of May 1986 (RJA 2863/1986) holds that, in the case of statements by co-accused (for organised crime charges), the protection of the presumption of innocence requires an assessment of the personality of the co-accused and his relationship with the defendant, a detailed and in depth examination of the motives (such as revenge or hatred) that may lead him to accuse an innocent person, as well as the search for a possible alibi that may induce him to exculpate himself.

Among the motives that a court should verify as justifying the conclusion that the accusation of a co-defendant is false, are the promise of better treatment made by the prosecution to induce a co-accused to give such statements (decision of the 4th of December 1991 (RJA 8970/1991)). The Court has also indicated that the reception, precision and certainty of incriminating statements may confirm their credibility (decision of the 21 January 1994 (RJA 90/1994)).

With decision of the 25th of March 1994 (RJA 2594/1994) the Supreme Court underlined the importance of the fact that there should be no elements putting into doubt the subjective credibility of the co-accused due to self-interest. It also stressed that it is important that the statements be consistent and reiterated.

In its decision of the 20 May 1994 (RJA 3942/1994) the Court also highlighted how an incriminating statement should be characterised by positive elements such as its spontaneous nature, logical coherence and repeated nature.

In decision 153/1997 the constitutional court held that a co-accused, differently from a witness, is not obliged to tell the truth and can remain silent or even lie. Thus the evidentiary value of his statements is weaker than that of witnesses especially when not corroborated by other evidence.

In two decisions (233/2002 and 237/2002) the constitutional court has summed up the criteria that need to be met in order to admit as evidence statements by co-accused and allow that their evidentiary value overcome the right to be presumed innocent of a co-accused:

- i. The incriminating statement of a co-accused is legitimate evidence;
- ii. Such a statement is not sufficient evidence to overcome the presumption of innocence;
- iii. Such minimal evidentiary value is acquired by such statements when they are corroborated by other evidence;
- iv. Such evidence required as a minimum to corroborate incriminating statements of co-accused to the point that they are considered as sufficient are facts, information or external circumstances that support the credibility/truthfulness of such statements;
- v. The assessment as to whether such corroboration exists is made on a case by case basis.

In decision No 84 of the 28th of July 1981 the constitutional court explicitly spelled out the concept of minimal evidence against the accused which in substance places a concrete limit on the principle of the free assessment of evidence by a judge.

In this decision the court specified that in order to attack the presumption of innocence it is necessary:

- i. That a certain minimal amount of evidence has been gathered;
- ii. That in gathering such evidence procedural rules have been respected (indicated both by legislative provisions and constitutional interpretation);
- iii. That such evidence gathered can be considered against the accused and is sufficient to imply his guilt;
- iv. That the evidence has been confirmed in the course of the oral hearing (with the exception of cases when evidence had to be gathered before trial but with the participation of an accused or when it is admissible to read statements in court);
- v. The free conviction of a judge that evidence is sufficient to prove the guilt of an accused is not sufficient but it will be necessary that he provides an adequate motivation as to how he reached the conclusion that an accused was guilty.

Switzerland

An accused individual is not required to give witness statement under oath (Article 82 CCP), this is because, potentially, a co-accused will be partial in his statements and his credibility is *per se* under doubt.

The different treatment of co-accused witness statements is confirmed by Article 169 which expressly admits that the right to remain silent applies to individuals whose statements may implicate them as co-accused. This exception to the rules compelling witnesses to appear in court and give statements is justified by the weaker evidentiary value of statements made by co-accused.

Article 178 states that co-accused, or accused in connected proceedings, may be questioned not as witnesses but rather as “persons in the know” (*persona informata sui facti/Auskunftspersonen*).

Portugal

In Portugal the Supreme Court and constitutional court have repeatedly ruled that the admissibility as evidence of the statements of co-accused in relation to their fellow co-accused only minimally collides with the right to fair trial, and is appropriate to the pursuit of legitimate objectives and criminal policy, in particular the fight against organised crime.

“Incriminating testimony made by co-accused is subject to the same rules means of proof”. As long as the accused has the chance to cross examine the co-accused, such evidence is admissible at trial (STJ 03.09.2008, *Rel Santos Cabral*¹⁰⁵).

In the absence of a specific regulation on the evidentiary value of statements made by co-accused, their credibility should always be measured in the light of the principle of free assessment, but with a special care, which might include a demand for corroboration.

This conclusion is justified by the fact that co-accused may be driven by dubious motives, such as the desire to get a deal or favourable judicial treatment, the spirit of revenge, hatred or resentment, or self-interest in excluding one’s own responsibility by accusing other defendants.

Although statements of co-accused are admissible as evidence, they have a limited value and, therefore, need corroboration by other evidence and require an increased duty on the part of the court to make a reasoned assessment (STJ 12.06.2008, *Rep. Santos Carvalho*¹⁰⁶).

The credibility of the incriminating testimony of co-accused is in direct proportion to the absence of subjective reasons for disbelief, which, in most cases, amount to the absence of spurious grounds and the existence of a self-incrimination.

¹⁰⁵ STJ 03.09.2008, *Rel Santos Cabral*, available at www.dgsi.pt

¹⁰⁶ STJ 12.06.2008, *Rep. Santos Carvalho*, available at www.dgsi.pt.

Corroboration is understood by the Supreme Court as an intrinsic characteristic as well as evidence that supports the finding of truthfulness.

The TC and STJ have also denied the value of incriminating statements made by co-accused, when, upon request of cross examination by the defendant, they avail themselves of the right to remain silent.

Incriminating Statements by co-accused are, however, admissible in a trial in absentia, although the defendant, through his counsel, should remain able to cross examine the co-accused and suggest the questions necessary to assess his credibility (Articles 6.º and 345. CPP).

3.3.4 Conclusions

Pursuant to Article 90 of the Russian Code of Criminal Procedure “the circumstances established by a sentence which has come into legal force or by another effective court decision passed within the framework of civil, arbitration or administrative court proceedings, shall be recognised by a court, prosecutor, investigator or inquirer without any additional verification. Such a sentence or decision may not prejudice the guilt of the persons, who have not taken part in the criminal case under consideration earlier”.

This provision significantly differs from similar provisions of other CoE member states in that, although it expressly mentions that the guilt of third parties may not be prejudged by a sentence, it nevertheless allows the application of preclusive effects of criminal judicial decisions in respect of other criminal proceedings (penal on penal) against third parties.

Such provisions create a risk that prosecutors and judges are exempted from proving essential elements of the charges against subsequent defendants through the importation of facts which have been “proven” in the absence of the defendants themselves. In this respect although their guilt may not be “prejudged”, a reversal of the burden of proof may lead to a disproportionate encroachment on their right to fair trial and in particular on defence rights and the right to be presumed innocent.

Another notable difference is that the countries examined limit preclusive effects to sentences which have been adopted following an examination of the evidence in adversarial proceedings. Guilty pleas and plea bargains (while giving rise to *res judicata*) do not usually entail preclusive effects in respect of subsequent proceedings even against the same defendants.

The preclusive effects of judgments in criminal cases may be misused when the statements by, or conviction of, a single defendant is employed in order to convict defendants in a related case. To prevent this encroachment on defence rights, several countries have, by legislative measures or through judicial interpretation, strongly limited and regulated the admissibility and evidentiary value of statements made by co-defendants in criminal proceedings.

3.4 Corporate liability for criminal offences

There are several ways in which the lack of effective corporate liability for criminal offences may facilitate misuse in corporate conflicts, elimination of corruption and forced takeovers, for example:

- A company may engage in anti-competitive behaviour by bribing public procurement officials with little risk for the company interests apart from some reputation damage and criminal punishment for the physical person who committed the illicit acts;
- It may be impossible to punish effectively illicit acts committed on behalf and in the interest of the attacker company in a raiding effort;
- Without adequate supervision and control procedures, which can serve as a defence or mitigating factor in a criminal case against a corporate entity, the entity itself may be vulnerable to misuse and corruption of its own employees.

Moreover the lack of effective corporate liability for criminal offences may in some cases be compensated for in a disproportionate or even somewhat arbitrary ways by prosecution bodies or courts seeking to freeze and confiscate assets of companies.

3.4.1 The Russian Federation

Recent years have seen a significant increase in the number of offences committed for the benefit of or with the use of legal persons. The scale of this phenomenon indicates that a new kind of crime, i.e. crime of legal entities (“crime of corporations” or “corporate crime”) has formed in Russia.

This kind of crime is a real threat to the economic security of the State as well as the interests of bona fide economic operators. In particular, it greatly increases the investment risk associated with exposure of Russian financial instruments to crime, which results in an outflow of capital from the country. Corporate crime destabilizes the fundamentals of the economy, contributing to the decline of key economic indicators, including a rise in inflation, reduction of production, transfer of capital to the shadow economy. Such crime contributes to the level of criminality in the society at large and, in particular, causes or facilitates corruption (including a special type of corporate corruption, i.e. illicit, selfishly motivated acts of civil servants for the benefit of particular legal persons).

The current criminal law of the Russian Federation has no concept of liability of legal persons. Article 19 of the Criminal Code establishes that criminally liable can be only a sane natural person who has reached a certain age. Hence the Criminal Code of the Russian Federation provides no sanctions for legal persons involved in crime. Instead, such sanctions are contained in the law on administrative offences, for example, Article 19.28 of the Code of Administrative Offences (unlawful compensation on behalf of a legal person) establishes the liability of legal persons for participation in offences under Articles 201 (abuse of authority) and 291 (active bribery) of the Criminal Code.

Article 14 of the Anti-corruption Law envisages that, in case, if on behalf of or for the benefit of a legal person, corruption offences or offences that create conditions for commission of corruption offences are organised, prepared or committed, the legal person may be held liable in accordance with the legislation of the Russian Federation.

The application of liability measures to a legal person for a corruption offence does not condone the guilt of the physical person for the corruption offence. Likewise criminal prosecution or other kind of liability of a physical person for an offence of corruption does not exempt the legal entity from liability for this offence. The approach is confirmed in existing case law where legal persons are held liable under part 1 Article 19.28 of the Code of Administrative Offences while the persons representing the legal entities are liable under part 1 Article 291 of the Criminal Code (the ruling of the Saratov oblast court of 28.05.2013 case N 7-297/13, decision of the Oryol Regional Court of 23.05.2013 case N 4-a-84/2013, the Volgograd Regional Court Ruling from 1 to N 7A-1061/11).

The current legislation on administrative offences of the Russian Federation does not provide the full range of sanctions adequate to the social danger of this kind of crime such as the revocation of a license, ban on the exercise of a particular activity, forced liquidation of a legal person, etc. It could be concluded that they do not fully meet the international standard of effective, proportionate and dissuasive sanctions.

3.4.2 International standards

Article 18 of the **Criminal Law Convention on Corruption of the Council of Europe**¹⁰⁷ requires “such legislative and other measures as may be necessary to ensure that legal persons can be held liable for the criminal offences of active bribery, trading in influence and money laundering established in accordance with this Convention, committed for their benefit by any natural person,

¹⁰⁷ *Criminal Law Convention on Corruption of the Council of Europe* is available at <http://conventions.coe.int/>

acting either individually or as part of an organ of the legal person, who has a leading position within the legal person, based on:

- a power of representation of the legal person; or
- an authority to take decisions on behalf of the legal person; or
- an authority to exercise control within the legal person;
- as well as for involvement of such a natural person as accessory or instigator in the above-mentioned offences”.

Moreover “each Party shall take the necessary measures to ensure that a legal person can be held liable where the lack of supervision or control by a natural person referred to in paragraph 1 has made possible the commission of the criminal offences mentioned in paragraph 1 for the benefit of that legal person by a natural person under its authority”. Liability of a legal person shall not exclude criminal proceedings against natural persons who are perpetrators, instigators of, or accessories to, the mentioned criminal offences.

Article 26 of **the United Nations Convention against Corruption**¹⁰⁸ requires the adoption by a State Party of “such measures as may be necessary, consistent with its legal principles, to establish the liability of legal persons for participation in the offences established in accordance with this Convention. Subject to the legal principles of the State Party, the liability of legal persons may be criminal, civil or administrative.” Similarly to the Criminal Law Convention on Corruption, the legal liability of a legal entity does not exclude the criminal liability of the natural persons who have committed the offences. It is required that sanctions shall be “effective, proportionate and dissuasive” and can be criminal or non-criminal, including monetary sanctions (an analogous requirement as found in Article 19, Paragraph 2 of the Criminal Law Convention on Corruption).

A similar requirement is found in Article 10 of **the United Nations Convention against Transnational Organised Crime**¹⁰⁹ for participation in serious crimes involving an organised criminal group and for several other offences established in accordance with the Convention.

In the European Union, **the Council Framework Decision 2003/568/JHA of 22 July 2003**¹¹⁰ on combating corruption in the private sector requires ensuring of liability of legal persons in relation to acts of corruption in the private sector.

The Recommendation R (88) 18 of the Committee of Ministers of the Council of Europe concerning liability of enterprises having legal personality for offences committed in the exercise of their activities¹¹¹ was designed to promote measures for rendering enterprises liable for offences committed in the exercise of their activities. The recommendation has invited State members to make enterprises subject to both criminal and other forms of liability for illicit behaviour when appropriate. The recommendation has also indicated that sanctions appropriate to the nature and structure of enterprises should be adopted in order to recover proceeds of crime, prevent further offending or the continuance of an offence. Such sanctions, which should be adopted in the respect of the proportionality principle, include among the others warnings, fines, confiscation of proceeds or instrumentalities of crime, exclusion from fiscal advantages or subsidies, annulment of licenses, appointment of a provisional caretaker management by the judicial authority, closure or winding up of the enterprise, prohibition upon advertising goods or services and restoration to the former state.

3.4.3 Council of Europe member states

The concept of Corporate Criminal Liability (hereafter CCL) states that criminal acts committed by the representatives of a “corporate entity” (hereafter CE) can be attributed to the CE which is thereby

¹⁰⁸ *United Nations Convention against Corruption* is available at www.unodc.org/

¹⁰⁹ *United Nations Convention against Transnational Organised Crime* is available at www.unodc.org/

¹¹⁰ *Council Framework Decision 2003/568/JHA of 22 July 2003* is available at <http://eur-lex.europa.eu/>

¹¹¹ *Recommendation R (88) 18 of the Committee of Ministers of the Council of Europe concerning liability of enterprises having legal personality for offences committed in the exercise of their activities* is available at www.coe.int

liable. The following is a brief overview of how the concept of CCL operates in 6 European States (France, Germany, Italy, Spain, Switzerland, and the UK). Germany does not have CCL as such but does take stern regulatory action where offences have been committed by CEs.

Each country is examined separately using the following format:

Fundamentals: What is the basis of CCL (or its equivalent) in the national law? Are all CEs open to CCL? (France, for example, exempts CEs that are part of the State.)

For the actions of which of their representatives may CEs be held liable? (Spanish law, for example, explicitly includes the offences of contractors in addition to regular employees.)

What is the exact relationship between a CE and its representatives? Switzerland, for example, usually only allows a CE to be prosecuted where an individual offender cannot be identified. In most cases CCL only applies where the CE benefited from the offence but that benefit does not have to have been exclusive (e.g. an individual may benefit directly while still benefiting the CE).

Are there specific offences to which CCL can or cannot apply? Some States limit CCL to specific offences but all agree that CCL applies to “business crimes” such as fraud, bribery, and money laundering.

Defences: Are any specific defences allowed in law? Will prosecutors take any other factors into consideration as mitigation? (Many States specifically allow a CE to argue that it had in place robust and effective “compliance” programmes intended to prevent any wrongdoing.) Even if such compliance does not offer a complete defence it will often be a mitigating factor. Most States will also mitigate a sentence where a CE has “self-reported” any offences it discovers and/ or co-operates fully with any investigation.

Procedure: Who prosecutes corporate crimes? Some States limit investigations to criminal prosecutors but others have several criminal and regulatory bodies that can enforce CCL. The UK specifically requires prosecutors to consider the “public interest” and this is examined in more detail.

Penalties: The usual penalty in the States considered is a fine the maximum amount of which may be limited by legislation. A variety of other penalties can be applied to CEs of which the most common is some form of “blacklisting” from bidding for public contracts. For obvious reasons CEs cannot be imprisoned but that penalty can be applied to a CE’s officers. It is also common for guilty individuals to have restrictions placed on their future involvement with CEs.

France

Fundamentals: France has recognised corporate criminal liability since 1994 although its scope was greatly increased in 2004. This has led to a large increase in the number of prosecutions.

The French State and (in certain circumstances) local public authorities are considered to be CEs but are not liable for the actions of their employees. Other CEs can be held liable for the actions of their legal representatives including those acting under an express power of attorney. The CE may also be responsible where no offence was committed by a specific person but negligence occurred as result of some defect in the CE’s organisational structure. This latter approach is becoming increasingly prevalent in the case law.

Liability on the part of a CE does not automatically entail liability on the part of directors and officers but neither is it precluded. For example, the general director of a company may be held criminally liable for the same offence as his company if it had been committed with his consent, assistance or neglect. At present, despite the recent extension of the laws applicable to CCL, most prosecutions are brought against individuals rather than the CE to which they are connected.

Defences: The employee was acting on own behalf. For this to apply the employee must not have been engaged in any business intended to benefit the CE. The existence of adequate compliance procedures on the part of the CE may prove a mitigating factor but do not provide an actual defence.

Procedure: The public prosecutor is responsible for all CCL cases. The regulator (*Autorité des Marchés Financiers*) has no involvement with criminal matters. The French legislation foresees the possibility for the judge to take in consideration the co-operation of the CE with the prosecutor or investigating judge. However, there is no sentencing guideline in relation to the mitigating effects that such cooperation may bear.

Penalties: Fines will be imposed in most cases where criminal activity is found (the maximum fine for a CE is five times that which can be imposed upon a private individual). French law provides for a wide range of additional penalties including, prohibition to exercise directly or indirectly one or more professional activities either permanently or for a maximum period of 5 years, permanent closure of one or more of the premises of the CE, temporary or permanent disqualification from public tenders and in the most extreme cases, dissolution of the CE.

Individuals can be fined, imprisoned, and have restrictions placed on their future involvement with CEs. It is possible for penalties to be lessened in return for an admission of guilt but this is more usual for individuals than for CEs. Co-operation with an investigation may be taken into account when determining penalties and the court will ordinarily consider the amount of harm caused and profit realised etc. Aggravating factors (e.g. repeated offences) must be taken into account when imposing a sentence.

Germany

Fundamentals: At present the German criminal law applies only to natural persons and, therefore, CEs cannot be charged with criminal offences directly. A CE may be penalised for offences (both criminal and regulatory) committed by its officers and employees and there has been an increasing number of such cases in recent years. There is debate whether Germany should change the law to allow direct CCL in line with other European countries and the USA.

Defences: There are no specific defences in German law. The court may refrain from imposing a penalty if it believes that the wrongdoing occurred despite measures put in place by the CE to prevent such offences. Although the imposition of a regulatory fine does not require prior conviction of an employee, it does require some finding of wrongdoing

Procedure: Alleged offences may be investigated by either State prosecutors or by regulatory authorities as appropriate. Fines may be imposed by either investigating body but only prosecutors are able to make forfeiture orders.

Penalties: A regulatory fine may be imposed. This will ordinarily be to a maximum of EUR 1 million but a greater amount may be determined if the CE's wrongdoing has brought it a financial benefit of greater than EUR 1 million. Where the court finds that a CE has benefited from the wrongdoing of an individual it may make a forfeiture order. This order removes from the CE an amount equal to the gross proceeds of the offence. CEs may also be penalised via procurement bans. Besides fines against individual offenders, the CE owner or representative can be held liable if he has failed to adopt appropriate measures of supervision which could have prevented the violation. Such measure may include selection of staff, organisational measures, monitoring and responsive actions to misconduct.

Italy

Fundamentals: CCL has been a part of Italian law since 2001. The relevant legislation is known as Law 231.

A CE will be liable if an offence occurred as the result of an employee acting in any way for the benefit, or in the interests, of the CE. CEs are only liable for specific offences defined in Articles 24

and 25 of Law 231. These “relevant offences” include fraud directed at the State, cybercrimes, corruption, money laundering, obstruction of justice, and manslaughter. This list is due to be expanded to include environmental offences.

If an identifiable offence has been committed, the CE will be liable even if the individual(s) who actually committed the offence remain unknown or otherwise unable to be prosecuted directly.

Defences: If an offence was committed by the CE’s officers or employees, the CE will not be liable if it can demonstrate that it had in place effective and appropriate “organisational control protocols” designed to prevent such offences from occurring. These protocols must be overseen within the CE by a “Surveillance Committee”. As of 2012 the courts have only accepted these defences on two occasions.

There is no mechanism permitting CEs to volunteer information about offences, or otherwise assist an investigation, in return for lesser penalties.

Procedure: There is no public body responsible specifically for prosecuting CEs. Ordinarily (unless the crimes are very minor) CCL cases will be conducted in conjunction with any underlying criminal investigation. Under Italian law criminal prosecution is required whenever, *prima facie*, an offence has occurred.

Penalties: Each relevant offence carries its own maximum penalty which will usually be in the form of a fine. The maximum fine for a CE is EUR 1.549 million with the exception of the offence of “market abuse” for which the maximum fine is 10 times the amount of profit achieved by the abuse.

CEs can also be blacklisted and have restrictions placed on their business activities. The court can also require a disgorgement of profits and property in order to recoup any profits obtained through wrongdoing.

Spain

Fundamentals: CCL has only been a specific part of Spanish law since 2010. Accordingly there have been no significant prosecutions to date but the number of complaints of corporate wrongdoing is increasing. In addition to their legal representatives and employees, CEs are also liable for the conduct of contractors engaged in activity on behalf of the CE.

CEs are only liable for specific offences but these include fraud, corruption, money laundering, industrial espionage, and offences contrary to urban planning and environmental protection laws.

Ordinarily CE officers will not be held personally liable for offences committed by others. Spanish law generally requires that it be proven that officers had knowledge of, and approved, any wrongdoing. There are exceptions to this rule – e.g. for money laundering it is sufficient to demonstrate that officers were negligent in their management of employees.

Defences: CEs will not be held liable if they can demonstrate effective supervision of employees and contractors. Having in place organisational systems for the detection and prevention of wrongdoing can be a mitigating factor.

Admissions of guilt and co-operation with investigations will always be taken into account. Voluntary compensation of victims will also be considered in mitigation.

Procedure: Investigation of corporate offences is the preserve of Spain’s Investigating Courts but other bodies, including police, regulators, and the public, may report alleged wrongdoing to the Investigating Courts for prosecution.

Penalties: There is no maximum amount set on fines. These will be determined based on the profit for the CE from the wrongdoing.

A CE may be dissolved entirely or have its activities suspended for a maximum of 5 years. A CE can be blacklisted and have prohibitions placed on its commercial activities. These penalties can either be of an indefinite or a temporary duration (in the latter case for up to 15 years).

Individuals can be imprisoned, fined, or banned from acting as CE officers. In choosing the penalty, the courts will consider its suitability to prevent future crimes, social and economic consequences of the penalty, prior offending and whether the CE was used as an instrument of crime.

Switzerland

Fundamentals: CCL has been a part of Swiss law since 2003. Under Article 102 of the Swiss Penal Code CEs can be held directly liable for specific offences including bribery (both in Switzerland and abroad), money laundering, and financing terrorism.

For other offences a CE can be liable where both the wrongdoing occurred within the CE and for its benefit and where the organisational structure of the CE makes it impossible to identify a specific individual as the culprit. Accordingly it is not possible for a CE and any individual to be convicted of the same specific offence.

Defences: It is a complete defence to demonstrate that the wrongdoing occurred despite the CE having implemented all necessary and reasonable measures to prevent it.

Procedure: The investigation and prosecution of alleged offences is conducted by the Swiss criminal authorities. In such instances the CE will be treated as a suspect in the same way as would be an individual.

Penalties: The only penalties that may be applied to CEs are fines and the confiscation of any unlawfully acquired benefit. The maximum amount of any fine is 5 million Swiss Francs. Officers and employees of the CE may be subject to civil sanctions.

The United Kingdom

Fundamentals: The concept of vicarious liability has been a feature of UK law for well over a century. The scope of CCL in the UK has increased in recent years with the passage of new legislation dealing with corporate homicide (2007) and bribery (2010). Although there have been few cases to date the authorities have emphasised the importance of this legislation.

The UK also employs the “identification principle” that allows CEs to be prosecuted for offences committed by those officers who represent the CE’s “controlling mind and will”. CE officers will also be liable for wrongdoing if it can be shown that they facilitated the offence either wilfully or through negligence.

The only offences that cannot be committed by a CE are those which can only be perpetrated by a physical person and those for which the only possible punishment is imprisonment.

Defences: Many offences relevant to CEs are strict liability and there is, therefore, no possibility of a defence. If a defence is available for a specific offence, it will be described in the appropriate legislation. In cases of bribery, while ordinarily strict liability applies, a defence is allowed that the CE had in place adequate procedures intended to prevent the offence. Co-operation with an investigation will always be a mitigating factor and the authorities have been keen to promote the concept of “self-referral” by CEs.

Procedure: The UK has diverse public bodies able to investigate and prosecute alleged offences by CEs. Prior to its recent abolition, the Financial Standards Authority was the most high-profile of such

bodies. As the name suggests, the Serious Fraud Office investigates investment and corporate fraud, as well as corruption, in England, Wales and Northern Ireland.

When deciding whether to proceed with a prosecution, UK prosecutors will, in addition to believing that the case has a reasonable chance of success, have to consider whether the prosecution is in the public interest. The most significant factor will be the gravity of the offence which is reflected not only by the amount of any profit or loss but also by harm caused to the public, to shareholders, to financial markets and international trade, and to the international reputation of the UK and UK businesses. Other public interest considerations that may encourage prosecution include: that the CE has been responsible for similar offences in the past; that warnings were given to the CE and ignored; that the CE's compliance procedures were ineffective or insufficient; that the CE failed to report, in full, the wrongdoing when it first became aware of it; and that the offences appear to be spread wide throughout the CE.

Certain factors may serve to persuade the UK authorities that a prosecution is not in the public interest. Some of these are purely practical (e.g. where the CE is in the process of being wound up or where the offences occurred so long ago that the CE has, essentially, become an entirely different entity).

Other factors that may be taken into account include: that, upon becoming aware of it, the CE immediately took "genuinely proactive" measures to rectify the wrongdoing; that the CE has an effective compliance regime in place; that the offence appears to be due to a "rogue" element within the CE rather than endemic to the CE; and that there is no history of similar wrongdoing at the CE. Prosecutors will also consider whether civil or regulatory action will be preferable to criminal prosecution.

Penalties: No maximum level is set for fines and it is possible for a fine to be set at an amount sufficient to put a CE out of business. Other possible penalties for CEs are confiscation orders, compensation orders and public procurement blacklisting. Individuals can be imprisoned, fined, and disqualified from serving as an officer of a CE. Senior officers may also be open to civil suits in cases such as bribery.

In choosing the penalty the courts will consider a plurality of factors such as the level of culpability or the gravity of the harm caused. Guidelines have been issued to assess the seriousness of the offence and four levels of culpability have been identified to select the appropriate sentence, ranging from intention to harm to negligence. The level of cooperation and early acceptance of guilt are mitigating factors while immunity in case of cooperation is granted in limited cases.

3.4.4 Conclusions

Offences committed on behalf of and in the interest of legal entities represent a particular challenge if insufficient sanctions exist against the corporate entities and only physical persons are subject to effective and dissuasive penalties.

The Russian Federation has seen a significant trend of offences committed for the benefit of or with the use of legal persons. The current criminal law of the Russian Federation has no concept of liability of legal persons. Legal entities are subject to administrative liability while only physical persons can be held criminally liable. Two separate procedures of different types can apply for what is essentially a single offence with the participation of both individuals and an organisation. International standards do not oblige States to necessarily impose criminal liability on legal entities. However, the current legislation on administrative offences of the Russian Federation does not provide the full range of sanctions adequate to the social danger of corporate crime such as the revocation of a license, ban on the exercise of a particular activity, forced liquidation of a legal person, etc.

Direct criminal liability of corporate entities is a relatively new concept in many European countries. In addition to the Russian Federation, six countries were reviewed and only one of them does not have direct criminal liability of legal persons. Depending on the country, corporate entities may be held liable for actions of their employees, legal representatives and contractors engaged in activity on behalf of the corporate entity. Importantly, if a corporate entity has a robust compliance program to prevent wrongdoing, it may be considered a mitigating factor or even a complete defence. Possible penalties may include fines, confiscation of proceeds from the offence, public procurement blacklisting, suspension or restrictions on activities, dissolution, etc.

3.5 Liability for corruption in the private sector

A major vulnerability of a company is the possibility to bribe its management. A typical form of such corruption involves managers who give up interests of the legitimate shareholders and start serving the interests of a third party in return for an illicit benefit. Corrupt managers may sell out company assets below market prices, artificially undertake debts for the company, curb sales to worsen the financial situation of the company, disclose or give away company documents or seals, which are used by the attacker, etc. Then the legitimate owners of the weakened company may be subject to extortion (e.g. forced to engage in unbeneficial business transactions), insolvency proceedings may be initiated against the company or the enterprise may be simply deprived of its valuable assets.

Corporate corruption may also induce many other kinds of wrongdoing, which can affect competition, e.g. illegal sale of confidential information held by banks and other companies or extortion of unofficial payments by employees of retail chains from providers of goods.¹¹²

Box 4. Examples of raiding schemes based on corruption of company officials

A typical scheme of raiding capture involves taking control of the CEO (Chief Executive Officer the director general) and then selling the real estate of the company as quickly as possible to the raider at a negligible price.

The raider may also start by making an agreement with the executive director (sales and marketing director, chief accountant) of a joint-stock company (for example, through bribery or blackmail, which is impossible to prove). Then, on behalf of the joint-stock company, the director buys some cheap but overpriced goods. This in itself would be a fully legitimate purchase. As a next step, the director slightly sabotages the company's production leading to a bankruptcy where a claim amounts to, for example, 10% above the value of all stocks and other debts. The joint-stock company is officially recognised as bankrupt and soon enters under external control, which does not provide for any coordination with shareholders. Note that the insolvency practitioner acts according to the law on bankruptcy rather than the law on joint-stock companies. Only the creditors' assembly controls him/her. Further the lenders require the outside manager to issue additional shares in value, which corresponds to the amount of the debt, and demand the shares in repayment of the loan. As a result, the raiders obtain a controlling stake.

3.5.1 The Russian Federation

The "internal corruption" when management decisions in the organisations of the private sector are made on grounds that not only run counter to the interests of the society and the State, but also to the long-term interests of the company and its employees represent a particular danger.

Commercial bribery as a form of corruption in the private sector includes both an offence within the scope of Article 204 of the Criminal Code and other offences (civil, disciplinary, administrative, etc.). At the moment, because of the lack of studies on the danger of private sector corruption, it is hard to assess exactly the harm created by the commercial bribery in particular and the danger of corruption

¹¹² Debate at the meeting of the Corruption Prevention Sub-committee of the Defence, Home Affairs and Corruption Prevention Committee of the Saeima, Riga, Latvia, 19 February 2013.

in the private sector in general. It is clear that commercial bribery has all the characteristics of corruption. The public danger of commercial bribery has the following characteristics:

- commercial bribery speeds up individual operations but the number of such operations, requiring the participation of the corrupt manager, could grow so large that expenses for corrupt payments will outweigh the gains of acceleration, and the use of “petty corruption” will lead to demands for higher payments;
- the corrupt person, as the result of bribery, selects applicants who possess information about corruption schemes, are confident in their use and are, therefore, the most effective in this system of relationships;
- a corrupt administrator who receives bribes does not give preference, upon choosing a contractor, to the most effective application in terms of the ratio of price and quality but selects the application that creates conditions for the receipt of benefits for private purposes;
- a corrupt claimant, using bribery, excludes other participants from the competition because they lack the ability to use corrupt relations and cannot compete in a situation where the basic criterion of choice is a “corrupt payment”;
- the level of corruption, including commercial bribery, influences the assessment of the investment attractiveness of a project;
- corruption makes managers direct spending through channels that facilitate the collection of illegal fees. This creates a bias to the high-cost and large-scale investment projects and the self-interest of corrupt managers forces them to demand higher levels of investment;
- the larger the share of the contract price, which must be paid by the organisation in the form of commercial bribe, the more likely is the choice of the “informal procedure” for the implementation of activities, which in turn will affect the growth rate of the economy;
- the longer the entrepreneur must wait for a decision on an issue, the more likely that the manager will receive the commercial bribe, because while the entrepreneur expects that decision, he/she incurs additional costs that can be avoided by passing a bribe. This situation reduces incentives for large investment in innovative projects, decisions on which take a long time while the cost recovery will come only after a few years.

In the process of business disputes arising on the basis of commercial bribery in the private sector, “raider attacks” may emerge. This is accompanied by a decrease in investment capacity, curbed development of small and medium business, suppression of competition, and general damages to the economy.

Despite the obvious danger of corruption in the private sector, Russian anti-corruption legislation (other than criminal) focuses on the detection and combating of corruption in the areas of public and municipal service and, in fact, ignores corruption in the private sphere.

The Criminal Code of the Russian Federation includes corruption offences (giving and receiving of a commercial bribe, abuse of power) providing liability for some of the most dangerous types of corruption in the private sector. However, despite the high prevalence of such acts, these provisions are practically not applied, thus substantially undermining the credibility of the criminal law.

3.5.2 International standards

Articles 7 and 8 of **the Council of Europe Criminal Law Convention on Corruption**¹¹³ require that each party criminalize active and passive bribery in the private sector and to this end shall adopt such legislative and other measures as may be necessary to establish as criminal offences under its domestic law, when committed intentionally in the course of business activity:

¹¹³ *Council of Europe Criminal Law Convention on Corruption* available at <http://conventions.coe.int/>

“the promising, offering or giving, directly or indirectly, of any undue advantage to any persons who direct or work for, in any capacity, private sector entities, for themselves or for anyone else, for them to act, or refrain from acting, in breach of their duties;

the request or receipt, directly or indirectly, by any persons who direct or work for, in any capacity, private sector entities, of any undue advantage or the promise thereof for themselves or for anyone else, or the acceptance of an offer or a promise of such an advantage, to act or refrain from acting in breach of their duties.”

The required sanctions shall be effective, proportionate and dissuasive, “including, when committed by natural persons, penalties involving deprivation of liberty which can give rise to extradition”. At least in one respect, the standard concerning bribery in the private sector is less stringent than with regard to the public sector, i.e. it must be proven that the bribe was intended to induce action or refraining from action in breach of duties of the recipient.

Article 21 of **the United Nations Convention against Corruption**¹¹⁴ requires that State Parties consider adoption of a practically identical standard to the Articles 7 and 8 of the Council of Europe Convention.

Along the same lines, in the European Union, **the Council Framework Decision 2003/568/JHA of 22 July 2003 on combating corruption in the private sector**¹¹⁵ requires criminalization of active and passive corruption in the private sector. The framework decision makes it explicit that the criminalization should cover business activities within both profit and non-profit entities while allowing a member State to declare that it will limit the scope to such conduct which involves, or could involve, a distortion of competition in relation to the purchase of goods or commercial services. The framework decision adds to the standard of “effective, proportionate and dissuasive” penalty a specified limit “of a maximum of at least one to three years of imprisonment”. Member States should also ensure, in case of conviction of a nature person, “that person may, where appropriate, at least in cases where he or she had a leading position in a company within the business concerned, be temporarily prohibited from carrying on this particular or comparable business activity in a similar position or capacity, if the facts established give reason to believe there to be a clear risk of abuse of position or of office by active or passive corruption.”

3.5.3 Council of Europe member states

In corporate conflicts, particularly when facing threats of illegitimate forced takeover, enterprises are especially vulnerable if their own management is corrupt and can be bribed. Despite existing international standards, States in their anti-corruption policies and companies themselves often do not fully appreciate the importance of the persecution and prevention of private-to-private bribery. This part of the paper will provide brief insight in the criminal law provisions and policies in selected member States of the Council of Europe.

Criminal law provisions

Despite ostensibly clear international standards on the criminalization of bribery in the private sector, a fairly wide variation in the provisions of national criminal law in European countries remains. For example, a peculiarity of the **Belgian** law is criminalization of bribery of persons in private entities only if the actions or non-performance of actions, for which the advantage is promised, offered, given, requested or accepted, unbeknown to and without the authorisation of, as appropriate, his board of directors or annual general meeting, his principal or his employer (Article 504bis, Penal Code).¹¹⁶

¹¹⁴ *United Nations Convention against Corruption* available a <http://www.unodc.org/>

¹¹⁵ *Council Framework Decision 2003/568/JHA of 22 July 2003 on combating corruption in the private sector* available a <http://eur-lex.europa.eu/>

¹¹⁶ Criminal Code [*Code pénal*] available at www.ejustice.just.fgov.be/

This has brought concerns, particularly by GRECO, that it might exclude, for example, “cases of bribery agreements between the governing bodies of two organisations”.¹¹⁷

In **Germany**, imprisonment up to three years or fine are the possible sanctions for an employee or agent in a business enterprise, who demands, allows him/her to be promised or accepts an advantage in a business transaction in exchange of unfair preference in competition upon acquiring of goods or business services. The mirror offence provides the same sanction to a person who offers, promises or grants such advantage “for competitive purposes” (Article 299, Criminal Code).¹¹⁸ Harsher sanctions are provided for aggravated offences (Article 300). Importantly that the offences are limited to advantages in return for unfair preference in market competition and, as a rule, investigations are to be started upon complaint (Article 301).

Latvia has fairly comprehensive criminal law provisions against bribery in the private sector. Both accepting of benefits of material or other nature and acceptance of an offer of such benefit by private sector employees are criminalized. Moreover the acceptance of the benefit is punishable regardless of whether the action or inaction, which is expected in return, would be in breach of the authority of the person (the formulation of the law runs simply “using his or her” authority). The available sanctions vary depending on certain elements, e.g. the amount of the benefit but prison sentence is always one of the options (up to 5 years in the heaviest form) (Article 198, Criminal Law).¹¹⁹ The mirror offence of active bribery criminalizes offer of provision of a benefit (Article 199).

The Criminal Code of **Ukraine** criminalizes offer and provision of an undue advantage to an official of a legal entity of private law, regardless of its organisational and legal form for action or inaction, using his/her authority, in the interests of the person who offer or provides the advantage or any third person (Article 368-3, Paragraph 1, Criminal Code).¹²⁰ Mirror-wise reception of such advantage by an official of a legal entity of private law is criminalized, too. If the reception involved a prior conspiracy of a group of persons or extortion, the applicable sanctions are heavier (Article 368-3, Paragraphs 3 and 4). However, depending on the particular paragraph of this Article, the available sanctions are fines, prohibition to occupy certain positions or pursue certain activity and confiscation of property. The relatively low sanctions seem to reflect the perception of a somewhat lower level of danger caused by such offences.

A separate Article criminalizes active and passive bribery of persons who provide public services (auditors, notaries, appraisers, mediators, arbitrators, i.e. who are not public servants or officials of local governments but who carry out professional activity connected with the provision of public services (when fulfilling these functions) (Article 368-4).

In its evaluation, GRECO recommended “to amend current criminal legislation in respect of bribery in the private sector in order to clearly cover the full range of persons who direct or work for, in any capacity, any private sector entity as provided for in Articles 7 and 8 of the Criminal Law Convention on Corruption (ETS 173).”¹²¹

Probably one of the most advanced pieces of criminal legislation against bribery in Europe currently is the Bribery Act of **the United Kingdom**. The act covers both public-sector and private-sector bribery as the function or activity, to which the bribe relates, can be any function of a public nature, any activity connected with a business, any activity performed in the course of a person's employment, or any activity performed by or on behalf of a body of persons (whether corporate or non-corporate) – subject to certain conditions (Article 3).¹²² The United Kingdom defines as an offence “a failure by a commercial organisation to prevent a bribe being paid for itself or on its

¹¹⁷ GRECO (2009) *Evaluation Report on Belgium on Incriminations*, p.26 available at www.coe.int/greco

¹¹⁸ Criminal Code [*Strafgesetzbuch*] available at <http://dejure.org/>

¹¹⁹ Criminal Code [*Krimināllikums*] available at <http://likumi.lv/>

¹²⁰ Criminal Code [*Кримінальний кодекс*] available at <http://zakon2.rada.gov.ua/>

¹²¹ GRECO (2011) *Evaluation Report on Ukraine. Incriminations* available at www.coe.int/greco

¹²² *Bribery Act* (2010) available at www.legislation.gov.uk/

behalf”.¹²³ It is a defence if an organisation can prove that it “had in place adequate procedures designed to prevent” bribery by persons associated with it (Article 7, Paragraph 2).

Policies

Realizing the serious harm that can be caused by bribery in the private sector, it is striking to see that the vast majority of countries do not prioritize detection of this type of crime even if they do not have provisions requiring a complaint as a trigger of investigation. The thematic review of GRECO’s third evaluation round found that:

*“In quite a significant number of states GETs were aware of a perception that private sector bribery is a less serious form of corruption than public sector, which is viewed as a gross breach of the trust that the public places on public institutions, in particular judicial and legislative institutions. This characterisation is more commonly encountered in Eastern Europe and reflects the historic preponderance of official power over the citizen but it is also found elsewhere. The Andorran report, for example, reflects a clear view by the majority of interlocutors there that private sector bribery is less serious than that in the public sector. This is often reflected in disparity between the sanctions available for bribery for public and private sector bribery, which is considered below. Sometimes evaluation reports reflect the situation in which national laws include private sector provisions, albeit imperfectly perhaps, but an absence of any cases accompanied by a prevailing view drawn from interlocutors met by the GET strongly suggests that it is very doubtful that the law, either through legal lacunae or lack of understanding, would really catch private sector bribery. This is for example the case in Bosnia and Herzegovina.”*¹²⁴

In most countries, enforcement policies differ in relation to private-public and private-private corruption. It is common to employ specialised anti-corruption agencies to fight the public-sector corruption, organise State-sponsored awareness-raising campaigns and encourage people to report such wrongdoing. While, quite legitimately, the State choose a less intrusive approach toward the private sector (many corruption control tools such as publicly disclosed asset declarations would be almost unthinkable for officers of private companies), the absence of more active engagement is quite striking. In a review of the situation, it was possible to identify guidelines and requirement to have compliance standards against corruption as virtually the only major policy, which alongside corruption toward the public sector would target also the private-private bribery.

For example, the Ministry of Interior of **Germany** has issued Practical assistance for anti-corruption measures addressing the leadership of organisations as well as those who develop, introduce and implement compliance measures. The guidelines provide a methodology of risk analysis with elements that clearly target also private-to-private corruption risks. For example, they ask to assess whether the organisation itself has standardized contracting/ procurement processes, which ensure competition and are thoroughly implemented in practice (including an internal control system, use of the four-eye principle, division of functions/ structured processed, and job rotation); whether the organisation has approved and communicated rules for the acceptance of contributions (gifts hospitalities, invitations) and side jobs.¹²⁵

According to a study by the Martin-Luther-University Halle-Wittenberg and PwC anti-corruption programs German enterprises can be legally expected to satisfy the following four minimum requirements:

- Continuous explanation and education on legal requirements;
- Random checks of employees;

¹²³ GRECO (2012) *Second Compliance Report on the United Kingdom. Incriminations (ETS 173 and 191, GPC 2)*, p.3 available at www.coe.int/greco

¹²⁴ Macauley, R. *Fighting Corruption. Incriminations. Thematic Review of GRECO’s Third Evaluation Round*, pp.35-36 available at www.coe.int/greco

¹²⁵ Federal Ministry of Interior (2013), *Handbook on anti-corruption measures [Praktische Hilfestellungen für Antikorruptionsmaßnahmen]* available at www.bmi.bund.de/

- Sanctions for violations;
- Filled position of a compliance officer as well as anti-corruption representative.¹²⁶

The legally binding character of these requirements stems from the implementation practices of the Article 130 of the Law on Regulatory Offences, which foresees a fine of up to EUR one million for a failure of an owner of an enterprise to intentionally or by negligence ensure oversight measures that would prevent or substantially impede other violations.¹²⁷

Latvia is an example of a country where private-sector corruption has not been prioritized by the law enforcement agencies. No cases of passive or active bribery in the private sector were detected in 2008 and 2009. A gradual increase followed with one case detected in 2010, 2 cases in 2011 and 6 cases – in 2012.¹²⁸ Still detection is not necessarily followed by prosecutions and sentences. At the beginning of 2013, the Office for the Fight against Economic Crime of the State Police contained a unit with just two officers directly responsible for this area of crime.¹²⁹ Despite years of discussion on the need to supplement the authority of the country's Corruption Prevention and Combating Bureau with the competence to investigate bribery in the private sector, the proposal has not entered the agenda of the legislature.

The Bribery Act of **the United Kingdom** contains provisions that should have a preventive effect against both private-public and private-private corruption, namely, the requirement that the Secretary of State publishes “guidance about procedures that relevant commercial organisations can put in place to prevent persons associated with them from bribing” (Article 9, Paragraph 1).¹³⁰ The current guidance is split under six principles – proportionate procedures, top-level commitment, risk assessment, due diligence, communication (including training), and monitoring and review. Thus the guidance on due diligence explains:

“For example, in lower risk situations, commercial organisations may decide that there is no need to conduct much in the way of due diligence. In higher risk situations, due diligence may include conducting direct interrogative enquiries, indirect investigations, or general research on proposed associated persons. Appraisal and continued monitoring of recruited or engaged ‘associated’ persons may also be required, proportionate to the identified risks. Generally, more information is likely to be required from prospective and existing associated persons that are incorporated (e.g. companies) than from individuals. This is because on a basic level more individuals are likely to be involved in the performance of services by a company and the exact nature of the roles of such individuals or other connected bodies may not be immediately obvious. Accordingly, due diligence may involve direct requests for details on the background, expertise and business experience, of relevant individuals. This information can then be verified through research and the following up of references, etc.”¹³¹

Note that, in this example, the due diligence process is to be carried out with regard to associated private persons. While the company is expected to engage in the due diligence process in part to secure itself a defence against prosecution (see also the Chapter 3.4 on corporate liability for criminal offences), such an approach also transforms the way, in which relations between two private parties function. Overall the trend in the more advanced approaches appears to be that, on the level of prevention within private organisations, the distinction between bribe to public officials and bribes to

¹²⁶ PwC, Martin-Luther-University Halle-Wittenberg (2013). *Economic Crime and Entrepreneur mind [Wirtschaftskriminalität und Unternehmenskultur] 2013*, p.45.

¹²⁷ Law on Administrative Violations [*Ordnungswidrigkeitengesetz*] available at <http://dejure.org/>

¹²⁸ The Ministry of Interior of the Republic of Latvia (2013) [*Par koruptīviem noziedzīgiem nodarījumiem privātajā sektorā*], 18 February, unpublished letter.

¹²⁹ Information provided by the State Police during the meeting of the Corruption Prevention Sub-committee of the Defence, Home Affairs and Corruption Prevention Committee of the Saeima, 19 February 2013.

¹³⁰ *Bribery Act* (2010) available at www.legislation.gov.uk/

¹³¹ The Ministry of Justice. *The Bribery Act 2010. Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing* available at www.gov.uk/

private parties should not play a major difference (even if differences in the definitions of respective criminal offences remain).

3.5.4 Conclusions

Due to the lack of data, it is difficult to assess exactly the harm caused by corruption in the private sector in the Russian Federation. However, numerous sources attest that illegal corporate raiding schemes often involve corruption of company managers as a necessary element. Corrupt company managers have been known to make the companies vulnerable by maliciously incurring debts, otherwise obstructing their commercial activity or assisting in the forgery of company documents.

The Russian Federation has criminalized commercial bribery. However, according to GRECO the relevant provisions are not fully in line with international standards, e.g. the liability applies only to persons above a certain level of responsibility (performing managerial functions) and prosecution is instituted only upon the application of the organisation or with its consent. Other than the criminal law, the Russian anti-corruption legislation mainly focuses on the detection and combating of corruption in the public sector and somewhat neglects corruption in the private sphere.

Despite existing international standards, also many other States in their anti-corruption policies often do not fully appreciate the importance of the prevention and persecution of private-to-private bribery. Moreover fairly wide variations in the provisions of national criminal laws in European countries remain. The existing variety includes such features as the criminalization of only such acts as are unbeknown to the principals of the entity, limitation of coverage to acts committed for competitive purposes or significantly lower sanctions than for public-sector corruption offences. On the positive side, an important international trend is the development of guidance and prevention programs for and within companies against corruption.

3.6 Overuse and misuse of the criminal law in the regulation of business activity

An overuse and misuse of the criminal law in the regulation of business activity, involving violations of legal principles and finding its reflection not only in laws and court decisions but also in the practice of law enforcement can be noted in Russia. The initiation of criminal cases is possible when investigators or public prosecutors misinterpret the law and confuse boundaries between the areas of criminal and civil law because of either lack of knowledge or malicious intent.¹³²

An analysis of the current practice of investigation and review of criminal cases in the field of economic crime shows that the initiation of criminal proceedings is commonly used as one of the mechanisms for the resolution of civil disputes. Thus a corporate dispute is replaced with the criminal prosecution. The initiation of criminal proceedings on the basis of an application by one participant or a group of participants of a business partnership against another participant (a group of participants) of the same partnership for alleged theft of property or abuse of authority in their common company results in significant psychological and judicial pressure on a party in what is essentially a civil dispute (even reaching as far as detention under the Article 108 of the Code of Criminal Procedure). Such measure effectively excludes the possibility of the detained person to participate directly in the proceedings and present his/her position before the court. Moreover preliminary investigation bodies have broad powers to seize documents and other items from third parties, essential to a criminal investigation. Removal of such documents in advance of the civil trial may deprive a party of evidence and create significant obstacles to the protection of the interests of such person in the context of a trial.

¹³² In other cases, the police take money from one entrepreneur to open a case against a rival and encourage the latter to pay them, in order to close this case: "Reideram pochti vsegda pomogaiut chinovniki organov gosvlasti" (Bastrykin's announcement // RIA «Novosti». 2009. 12 Oct.; Poliakov S.B. Usloviia rossiiskoi pravovoi sistemy dlia zakaznykh ugolovnykh del // Advokat. 2009. no. 5; Vystuplenie nachalnika Departamenta sobstvennoi bezopasnosti MVD Rossii general-leitenanta militsii Iurii Draguntsova na strannitsakh zhurnala «Professional»"

Both the overuse of the criminal law and the excessive severity of punishments for economic crimes found in Russia are out of line with international practices. Both of these defects in the criminal realm hurt the economic development of the country and for this reason contradict state interests.¹³³ When assessing the fact of illegal criminal prosecution of businesses, experts have raised several significant points. They mention that there is imprecise *corpus delicti* of economic crimes such as fraud, abuse of office and illegal enterprise.

The most widely abused provision of the Criminal Code is **fraud**. Investigative authorities consider “fraud” to be a “rubber article”, meaning that it is capable of encompassing almost any entrepreneurial activity. Between 2000 and 2010 the proportion of opened fraud cases in a total number of economic cases has risen from 33.6% to 56.8%.¹³⁴

Parties to corporate disputes often resort to allegations that the other party has **abused his position**, in violation of Article 201 of the Criminal Code.¹³⁵ It has been foreseen that following the adoption of the amnesty for economic crimes (such as Articles 159 or 160) which has not covered this provision, the Article 201 will be increasingly abused by investigative authorities in particular as its formulation is quite vague and also because the opening of criminal cases for abuse of office can be done *ex officio* and does not require the filing of a complaint by the alleged victim.

Illegal enterprise¹³⁶, as explained in commentaries and a series of Guiding Explanations of the Supreme Court, came to refer mainly to violations of the rules of registration and licensing.¹³⁷ But these rules, themselves part of the administrative law, were subject to frequent change, and also administrative sanctioning (the normal way of enforcing rules of registration of business firms in Western countries). The introduction of this offense in the mid-1990s provided authorities with a new instrument for trying to regain control of economic activity after the collapse of state owned industry and spontaneous privatization, a large part of which took place, at least partially, outside of the law. Whether or not this crime was needed at the time (its peak of enforcement came between 1998 and 2002), the original grounds for criminalizing violation of administrative rules no longer exist.¹³⁸

In other cases, the over-criminalisation of violations in the field of **taxation** stems not only from the lack of specific provisions defining tax fraud and VAT fraud but from lack of coordination between investigative authorities and tax authorities.

Research also shows that the state authorities attempt to overcharge business for commission of multiple crimes. If in 2005 a difference between crime level per person (in the cases where multiple charges were imposed) and economic crime level per person (in cases where multiple charges were imposed) was 9.5%, on 2006 it became 18.7%, in 2007 – 21%, in 2009 – 34.4%.¹³⁹ Imposing several charges as many of them are vaguely construed leads to a harsher punishment.

¹³³ Peter Solomon Jr. *Improving criminal law in the Russian Federation: Business crimes and humanization*, available at: <http://lecs-center.hse.ru/>

¹³⁴ IECS (2012), *Roundtable on the impact of criminal policy on the economy [Воздействие уголовной политики на экономику]* available at www.lecs-center.org/

¹³⁵ “The use of authority by a person discharging managerial functions in a profit-making or any other organisation in defiance of the lawful interests of this organisation and for the purpose of deriving benefits and advantages for himself or for other persons or for the purpose of inflicting harm on other persons, if this deed has involved the infliction of substantial damage on the rights and lawful interests of individuals or organisations or on the legally-protected interests of the society or the State, shall be punishable...”

¹³⁶ Article 171 of the criminal code defines illegal enterprise as following: Exercising business activities without registration or without a licence where such licence is obligatory, as well as submission to the authority of the state registration of legal entities and individual entrepreneurs, documents containing false information or conducting business without a license in cases where such a license is required if the act caused large-scale damage to individuals, organizations or state or is connected with deriving profits on a large scale shall be punishable.

¹³⁷ V.I. Radchenko, ed. *Kommentarii k ugovolnomu kodeksu Rossiiskoi Federatsii* (SPb.: Piter, 2007); A.A. Chekalin, ed. *Kommentarii k ugovolnomu kodeksu Rossiiskoi Federatsii* (M.: Iurait, 2007)

¹³⁸ Peter Solomon Jr. above at 1

¹³⁹ Liberal Mission (2011), *Criminal policy in the economic sphere*, [*Уголовная политика в сфере экономики*] is available at <http://www.lecs-center.org/>

This chapter will focus essentially on two issues: the over-criminalisation of fraud and the relationship between tax authorities and investigative authorities

3.6.1 Fraud regulation

3.6.1.1 *The Russian Federation*

A core concern relating to the misuse of the criminalization of fraud is qualification of legal business activity within the sphere of the civil law as criminal fraud (due to either intentional misuse of authority by law enforcement bodies or just faulty, arbitrary interpretation of the definition of fraud in the criminal law).¹⁴⁰ Simple failure to execute contractual obligations is treated as a criminally relevant behaviour.

Article 159 of the Criminal Code establishes liability for fraud, in particular if committed by using a person's official position. Unlike other forms of theft under Chapter 21 of the Criminal Code, fraud is committed by deceit or breach of trust, due to which the owner of property or other person or authorised body transfer the property (or rights associated with it) to others, do not object against the removal of the property or against the acquisition of rights associated with the property by other persons.

Box 5. Misuse related to Article 159 of the Criminal Code of the Russian Federation

It is common for citizens to misuse their civil rights and apply to law enforcement agencies accusing another party of a criminal act (under the Article 159) because allegedly it has not performed its obligations in due time under a civil-law deal. In their turn, the law enforcement agencies violate the substantive law concerning charges under the Article 159 of the Criminal Code (without complete verification of the intent in the actions of a citizen who is under the civil liability and without verification of the activity of the company managed by the individual).

In December 2007, with the Plenary Resolution “On judicial practice in cases involving fraud, misappropriation and squander”, the Supreme Court issued guidelines for the interpretation and application of the Article 159 of the Criminal Code. The Court described fraud as a form of misappropriation of assets through false representation (“*obman*”) or abuse of trust. False representation is defined as the intentional communication of false information or the silence on circumstances aimed at inducing the victim into error. The false representation may concern any circumstance.

Abuse of trust is described as the abuse of fiduciary relationships with the owner of property or anyone who has the power to dispose of such property. Trust may be based on a variety of relationships such as professional position as well as personal or familiar relationships with the victim.

Fraud, in the interpretation of the Court also includes the undertaking of obligations without the intention to carry them out and with the goal of appropriating others' property. The intention not to carry out the obligations must have arisen before the acquisition of the control over other's property. Indicators of such malicious intention are described as the absence of financial means to carry out an obligation, the absence of the necessary licence, the use of false documents, the hiding of information on one's debts, the creation of a shell company. Such circumstances are however not sufficient to prove the guilt of an individual.

Federal Law №207-FZ of November 29, 2012 amended the Criminal Code aimed at the differentiation of responsibility for the various types of fraud, including those committed in the sphere of economic activity. In particular, the Criminal Code was supplemented by Articles 159.1-159.6

¹⁴⁰ H. Yashina (2013) *From entrepreneurship to fraud is one step? [От предпринимательства до мошенничества один шаг?]* Gazeta Yurist available at www.gazeta-yurist.ru/

providing liability for fraud committed in the sphere of crediting, entrepreneurial activity, insurance, computer information, and upon receipt of payment or with the use of payment cards. These types of crime represent specific varieties of the general offence of fraud, which is provided for in Article 159 of the Criminal Code.

Fraud in entrepreneurial activity in part 1 of Article 159.4 of the Criminal Code is understood as fraud involving deliberate default on contractual obligations in the field of entrepreneurship. This wording is quite general. The concepts of “entrepreneurship” and “crime in entrepreneurial activity” are not defined in the legislation of the Russian Federation.

It seems that the Article 159.4 requires proving that the person engaged in entrepreneurial activity committed or attempted to commit fraud and that these actions involved intentional non-performance of contractual obligations in the field of entrepreneurship. In some cases, the new penal provisions improve the position of the perpetrator of fraud in the specified areas. Therefore, in accordance with Article 10 of the Criminal Code the new provisions have a retroactive effect.

Currently a process of mass requalification from Article 159 to Article 159.4 is taking place since the persons sentenced under Articles 159.1 (fraud in crediting) and 159.4 (fraud in entrepreneurial activity) are covered by the amnesty. However, the amnesty does not cover those convicted under the “general” Article 159 (fraud). Because of the weak delineation between the terms fraud in general and fraud in entrepreneurial activity, some courts taking advantage of such gaps ignore the requalification. The review of case law on the application of the Federal Law №207-FZ of November 29, 2012 approved by the Presidium of the Supreme Court of the Russian Federation on December 4, 2013 and the ruling of the State Duma of the Russian Federation No.2559-6 GD of 2 July 2013 provide clarification on the application of requalification.

3.6.1.2 International standards: the contours of the dishonesty requirement and the delimitation between criminal and civil responsibility

Considering the substantial legal problems caused by this economic crime at both national and international level, with **the Recommendation of the Committee of Ministers R (81)12 on economic crime**¹⁴¹ members state have been invited to review their legislation on business activity in the light of the need to promote a coherent and comprehensive set of standards, easily understandable to all concerned, as well as a legal system flexible enough to cope with such economic crime as may occur as a result of future economic and technological development.

Fraud, one of the main types of economic crime, has been one of the most problematic figures to regulate due to the constant evolution of schemes adopted by perpetrators to defraud their victims.

Notwithstanding there is no single definition of fraud in the EU, the legislation and case law seem to consider necessary the following elements: need for a victim, a wilful act, misleading representation of facts (dishonesty), intention to achieve an economic advantage or to cause economic loss to a third party, and an unlawful act.

Besides regulating a basic “general” model of fraud all the countries have also introduced specific forms of fraud spamming such as embezzlement and abuse of trust , commercial fraud, computer fraud, subsidy fraud, tax fraud, VAT fraud, capital investment fraud, insurance fraud, obtaining credit by deception, misuse of cheques and credit cards.

Some of these specific forms are also becoming influenced by the EU directives and conventions.

¹⁴¹ Council of Europe, *Recommendation R(81) 12 on Economic Crime*, available at www.coe.int/

In 1995 the EU adopted the **Council Act of 26 July 1995 drawing up the Convention on the protection of the European Communities' financial interests**¹⁴² where specific types of fraud have been defined such as expenditure fraud and revenue fraud¹⁴³. **Directive 84/450 EEC**¹⁴⁴ and **directive 2005/29 EC**¹⁴⁵ “concerning unfair business-to-consumer commercial practices in the internal market” impose a partial limitation on the protection against fraud, restricting it to the average reasonable consumer.

Such directives, at least in respect of certain types of fraud, are leading to harmonization of criminal law and fraud in particular. This harmonization was expressly established at the end of 2009 in the Treaty of Lisbon amending the Treaty of the European Union.

3.6.1.3 Regulation of fraud in the Council of Europe member states

Based on the more or less restrictive interpretation of the dishonesty used by the fraudster as well as the importance given to other elements three models tend to be followed by CoE members: the first model is focused on the element of *furtum* (theft), the second model is focused on the deceitful behaviour (*falsum*) while the last model is focused on the material prejudice whereby the concept of deceit is interpreted loosely.

With respect to the deceitful behaviour of the fraudster, differences among European countries depend on whether such conduct is subject to more or less restrictive interpretation.

The French model of *escroquerie*, applies a restrictive notion based on a deceit requirement contained in the expression *manoeuvres frauduleuses* while it omits the requirement of the material element of property damage. The Spanish law has included a requirement of false pretences in the concept of fraud. Similarly the Italian Criminal Code has introduced a requirement of *artifizi o raggiri* (trickery) although the courts have eventually given a lax interpretation to the concept of deceit.

A wider interpretation to fraud is in use by United Kingdom and Germany. The British model focuses on a broad model of fraud encompassing any deception. The British Fraud Act of 2006 still refrains from including the occurrence of harm in its provisions, and formulates the notion of deceptive action in a broad manner, either through the inclusion of an implied “false representation” or through a wrongful omission encompassing also deception through computers and systems, and deception about legal questions. In Germany the provision on fraud through false pretences (*Betrug*), uses the narrowing element of harm to property, which the German court decisions have significantly expanded by underscoring the economic impact of the offense as a guiding principle. This broad conception of fraud through false pretences based on economic harm has however recently been significantly narrowed demanding danger to property or fraudulent inducement to contract.

Finally Nordic countries tend to apply fraud very widely as taking advantage of somebody else's mistake although with the added requirement of an unlawful conduct.

¹⁴² *Council Act of 26 July 1995 drawing up the Convention on the protection of the European Communities' financial interest*, 95/C 316/03) available at <http://eur-lex.europa.eu/>

¹⁴³ Expenditure fraud is defined as any act or deliberate omission involving the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities, non-disclosure of information in violation of a specific obligation, with the same effect; the misapplication of such funds for purposes other than those for which they were originally granted.

Revenue fraud covers any act or deliberate omission involving the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities, non-disclosure of information in violation of a specific obligation, with the same effect; misapplication of a legally obtained benefit, with the same effect.

¹⁴⁴ *Council Directive 84/450/EEC of 10 September 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising*, available at <http://eur-lex.europa.eu/>

¹⁴⁵ *Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65 /EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive*, available at www.esma.europa.eu/

In all the countries analysed, the Supreme Courts have engaged in an often intense work of clarification of the elements of fraud in order to delimit its contours and to differentiate hypotheses of civil and criminal responsibility. In UK the legal guidance issued by the Crown Prosecution Service in respect of the Fraud Act 2006 has stressed that prosecutors should guard against the criminal law being used as a debt collection agency or to protect the commercial interests of companies and organisations. The criminal law should not be used to protect private confidences.

The court interpretation has also reflected the evolution of society as behaviours capable of inducing in error and causing a patrimonial loss have changed over time and a monolithic approach has been considered as inconsistent with the fundamental principle of causality between conduct and prejudice.

As explained above notwithstanding differing definitions of fraud, the case law of most European countries has strengthened over the years a requirement concerning the behaviour of the perpetrator which must include specific manoeuvring/ trickery aimed at inducing the victim in error. These specifications have also led to a clearer distinction between civil and criminal fraud in the field of contractual relationships.

Italy

The general fraud offence provides for the punishment of anyone who, through artifices or deceptions, inducing someone in error, obtains for himself or others an undue profit causing damage to others (Article 640, Criminal Code).¹⁴⁶ This offence is punishable by imprisonment from six months to three years.

This general provision is used where other specific offences do not apply, and it expressly provides for an aggravating circumstance where the fraud is against the state, which increases the punishment up to five years' imprisonment.

Artifices and deceptions have been interpreted as distinct behaviours as the former have been interpreted as a *mise en scène* which is misrepresentation of reality aimed at convincing that something that does not exist exists or vice versa, while deception has been interpreted as psychological manipulation through a deceitful and ingenious activity aimed at inducing in error the victim.

In Italy breach of contract will lead to criminal liability only when the other party has been induced to agree to a contract following artifices and deception. Artifices and deception may also include omissive behaviour when a party dishonestly fails to inform the other party of circumstances he has a duty to disclose irrespective of whether the other party may be able to find them out by reasonable diligence.¹⁴⁷ The duty to inform may stem from general rules of conduct and not only from statutory provisions.¹⁴⁸

For example the Supreme Court held that the sale of real estate for the purpose of using it as residential dwelling when the building was located in an area exclusively dedicated to hotels amounted to fraud as the seller had omitted to provide such information.¹⁴⁹ The preliminary sale of a building that had already been sold to third parties was also considered as fraudulent when the seller

¹⁴⁶ The law punishes “Whoever by using trickery [artifici o raggiri] induces another person in error and obtains for himself or others an unfair advantage while damaging the victim”. The penalties are increased if the fraud was committed against state authorities ... if the crime has been committed by inducing the victim to fear that a danger that does not exist in fact exists, or by making him believe that he has to obey the order of an authority.

¹⁴⁷ Cass. pen., sez. II, 30 ottobre 2009, n. 41717

¹⁴⁸ Cass. Sez II, 2/03/1996

¹⁴⁹ Cass. pen., sez. III, 15 gennaio 2007, n. 563

had failed to inform the purchaser of the existence of a previous sale irrespective of whether the previous contract had been invalid.¹⁵⁰

The fact that payment of a fair price has taken place is not an impediment to the existence of fraud if the contract would have not been concluded in the absence of artifices and deception by one party.¹⁵¹

Fraud can also take place at the execution stage of a contract if in order to avoid or postpone a claw back action on the part of creditors, the debtor uses invalid sureties giving a false representation as to his solvency.¹⁵²

France

The French legislation and case law on fraud are comparatively very restrictive as Article 313-1 of the French Penal Code¹⁵³ sanctions individuals who deceive an individual or corporation only if the deception took place in specific ways: by using a false name or fictitious capacity, by abusing a genuine capacity, or by means of an unlawful manoeuvre, thereby leading that person or corporation to transfer funds or property, or to provide a service, to the detriment of that person or corporation, or a third party.

The penalty for breach of this article is a five-year term of imprisonment and a fine of €375,000.00. However, Article 313-2 increases the penalty in certain circumstances, depending on who committed the fraud. An increased seven-year term of imprisonment and a fine of €750,000.00 are imposed if the fraud was committed by any of the following:

- a person holding public authority or discharging a public service mission;
- a person unlawfully assuming the capacity of a person holding public office;
- a person making a public appeal.

Under Article 313-9, legal persons may incur, amongst other things, a fine to a maximum amount of five times that which is applicable to natural persons, placement under judicial supervision for a maximum of five years, or disqualification from public tenders.

The Court of Cassation has consistently held its interpretation of “fraudulent machinations” as requiring combination of facts, the arrangement of schemes, organisation of tricks, a staging aimed at giving credit to a lie.¹⁵⁴

Unlike German, Italian and Swiss judges, French courts refuse to qualify a simple lie a fraud. The form of the lie is irrelevant: verbal, written, due primarily to false accounts, false orders, repeated or single lies, lies disseminated by any method or sent to a single victim. The French case law is, in this respect, consistent: whatever the lie, it is not sufficient to give birth to criminal liability. A lie must take place within a scheme of fraudulent manoeuvring unless the law specifies otherwise.

In the same vein, the Supreme Court noted that the use of a hype (misleading advertisement) such as posters, cupboards, flyers or announcements in the press was no longer only a written lie, repeated or not but truly the organisation of a true staging false representation designed to give credit to lie. It has been found that the distribution of promotional cards falsely announcing that the defendants had a big contract with a major company was a scam, element of the tort of fraud.¹⁵⁵

¹⁵⁰ Cass. pen., sez. I, 12 giugno 2006, n. 19996

¹⁵¹ Cass. pen., sez. II, 22 dicembre 2008, n. 47623

¹⁵² Cass. pen., sez. II, 14 febbraio 2012, n. 5572

¹⁵³ Fraudulent obtaining is the act of deceiving a natural or legal person by the use of a false name or a fictitious capacity, by the abuse of a genuine capacity, or by means of unlawful maneuvers, thereby to lead such a person, to his prejudice or to the prejudice of a third party, to transfer funds, valuables or any property, to provide a service or to consent to an act incurring or discharging an obligation. Fraudulent obtaining is punished by five years' imprisonment and a fine of €375,000. *French Criminal Code [Code pénal]* is available at www.legifrance.gouv.fr/

¹⁵⁴ Crim. May 11, 1971, Bull. crim. No. 145

¹⁵⁵ Cass.Crim, May 18, 1981, No. 80-91888

So for example “the opening of a bank account for the sole purpose to be issued a chequebook for creating the appearance of solvency and the use of checks to obtain the delivery of merchandise with the intention, from the outset, not to pay the price are a ploy characterizing the constituent fraudulent machination”.

In French law, fraud is a crime of commission, not omission as confirmed by the requirement of specific forms of deception listed in Article 313.1. The supreme court refused to admit that fraud had been committed when the culprit has been silent on the termination of his agency contract and received from a client a sum owed to the person he used to represent, similarly the court excluded fraud when an individual, taking out a large loan, failed to reveal that he is in a state of bankruptcy, this reluctance cannot be regarded as a corrupt.

In this respect French law is very different from other countries where fraud can also take place by omission such as Germany or Switzerland where an individual may be held liable of fraud by simply keeping a person in error by failing to inform him about his mistake or about certain circumstances.

Under German law, it is possible to deceive the victim through lying by omission while the French law considers that the fraudulent machination requires the performance of positive acts. There is therefore a set of manoeuvres punishable under German law which are non-punishable under French criminal law. Thus, the French law follows a different logic than the German criminal law; Article 313-1 of the French Penal Code protects only vigilant victims.

Spain

The Spanish law, following several amendments to the Criminal Code over the years, has included a requirement of false pretences in the concept of fraud. After having at earlier times copied from the French Model, the Spanish law introduced in the *estafa* provision of its new Penal Code of 1995 the requirement that the perpetrator carry out a deception (*engaño bastante*) of such a magnitude as to be capable of inducing a mistake.¹⁵⁶ The emphasis is placed on the victim of the fraud as among the relevant considerations for the criminal liability is whether the deception was sufficient to induce a mistake in a reasonable person.

The rulings of the supreme court (*Sentencia del Tribunal Supremo* – hereinafter STS) 484/2008, of 5 May and 787/2011, of 14 July, define the scam as “an artifice created by someone in order to make believe as certain a situation that is not certain, as a way of inducing in error another, who by believing this false representation transfers a good in favour of the author, which is enriched illegally, resulting in financial loss to the second”.

The elements that compose the crime of fraud, according to the guidelines of the doctrine and jurisprudence¹⁵⁷ are:

- 1) The use of a prior deception by the perpetrator, sufficient to create an inadmissible risk to the legal right; this adequacy, suitability or fitness of deception is to be established under a mixed objective - subjective standard based on the assessment of the level of insight of the average citizen as well as on the specific circumstances of the case;
- 2) The deception must trigger the error of the victim of the action;

¹⁵⁶Artículo 248 (Estafa)

1. Cometan estafa los que, con ánimo de lucro, utilizaren engaño bastante para producir error en otro, induciéndolo a realizar un acto de disposición en perjuicio propio o ajeno.

2. También se consideran reos de estafa:

a) Los que, con ánimo de lucro y valiéndose de alguna manipulación informática o artificio semejante, consigan una transferencia no consentida de cualquier activo patrimonial en perjuicio de otro.

b) Los que fabricaren, introdujeren, poseyeren o facilitaren programas informáticos específicamente destinados a la comisión de las estafas previstas en este artículo.

c) Los que utilizando tarjetas de crédito o débito, o cheques de viaje, o los datos obrantes en cualquiera de ellos, realicen operaciones de cualquier clase en perjuicio de su titular o de un tercero.

¹⁵⁷ STS 465/2012 of 1 June 2012

- 3) There must also be a transfer, precisely because of the mistake, to the benefit of the author of the fraud or a third party;
- 4) The deceptive conduct must be executed wilfully and for profit; and
- 5) It must result in damage to the victim, and the damage must be causally linked to the deceitful conduct of the perpetrator.

Difference between civil and criminal fraud in Spain

The STS 109/2013, of 17 January, recalled that “the dividing line between criminal fraud and civil fraud, in crimes against property, is situated in type of the fraudulent behaviour so that only if the agent's conduct is within the ambit criminalized by the penal precept as fraud, will be the conduct criminally punished while any breach of contract will not be punishable, because the legal system provides remedies to restore the rule of law when it is violated and the interests protected are purely individual”.

Projecting this distinction in the field of business activities, fraud will take place when a deception is at the origin of the breach of contract, for example when one party simulates his solvency from the outset in order to contract with another person, without any intention to fulfil his obligation.

This the existence of an initial deception at the origin of a contractual breach, gives rise to fraud as from the outset there is a mismatch between the inner will of one party not to comply with the contract terms and the externalized and misleading representation to the other party of the will to comply.¹⁵⁸

Also the STS 352/1997, of 18 March, acknowledges that “it is sometimes difficult to draw the line between civil and criminal fraud, but the latter can only be assessed when the conduct fits fully in the criminal provision. This occurs when, behind the guise of a regular contractual will, there is an intention to hide, conceal, falsely represent that causes the error of the other party, the transfer of assets, and the loss for one party and unjust enrichment for the party who used deception for profit.”¹⁵⁹

According to the STS 61/2004, of 20 January, *engano* (deceit) arises when the author simulates a serious intent to given contractual terms, while in fact only having the intention to take advantage of the services the other party agrees to, and conceals his intention of breaching its contractual obligations, hence taking advantage of trust and good faith of the victim through fraudulent schemes.

The supreme court has also clarified that fraud will not take place if this fraudulent intention not to abide by the contractual terms arises after the conclusion of the contract. Without any doubt the element of the intent must precede all the other elements of fraud.¹⁶⁰

The Spanish case law has also specified that the false representation (*simulacion*) of a non-existing intention to execute the contract requires that the deception (*engano* in Spanish) is sufficient to deceive and induce in error the other party. In fraud the author knows from the very beginning that he will not, or will not be able to abide by the contractual terms.¹⁶¹

There has to be a causal relationship between the deception and the prejudice caused to the other party and the author must be aware that such prejudice will induce in error and cause prejudice.

Finally, the STS 1117/1996, of 31 December, notes that “while in civil fraud insidious words or machinations by one party to induce another to enter into the contract, leaves the possibility, however

¹⁵⁸ STS 14 June 2005

¹⁵⁹ see also the STS 1045/1994 of 13 May and 987/1998, of 20 July

¹⁶⁰ STS 393/1996, de 8 de mayo

¹⁶¹ STS 1045/1994, de 13 de mayo

remote, to implement the terms of the agreements, the criminal fraud requires in the author of the breach the intention or clear knowledge that execution will be impossible or highly problematic”.

In decision STS 2202/2002, of 2 January, the supreme court stated that “when a disproportionate value was attributed to a good, there could be no fraud, when the disproportion was readily apparent to the recipients of the fraudulent conduct, and they could, even with the help of timely verification of state registers, find the true value of the property on the market”.

The STS 274/2012 of 4 April, stated that mendacity “does not necessarily equate to lack of truth as deception requires not only the absence of truth, but also the awareness of such absence and the intention/will that such absence is not be perceived by the victim (the will to conceal)”.

Fraud will take place both, when there is awareness that the deceit will induce in error or that it is likely to induce in error the other party.¹⁶²

Finally the supreme court has addressed the distinction between fraud and embezzlement: The SSTS 104/2012, of 23 February and 236 /2012, of 22 March 2012, noted that even though the crime of embezzlement is similar in the result , as there is an enrichment at the expense and injury of another’s patrimony, there is a substantial difference between the two regarding the specific intent thereof, while in the scam there is use of deceptive machinations abusing the good faith and credulity/belief of the victim, in the misappropriation the issue is not about deceit but the abuse of trust than was placed on the offender.

The crime of misappropriation does not requires deception as a relevant element and cause of criminal behaviour , but rather the lucrative intention arises after the perpetrator has received in his possession the good by the other party. This means that when the fiduciary relationship was established, the perpetrator did not have already an illicit intention but after receiving the receiver unilaterally breaks the trust relationship and the agreement between him and the other party (victim), by disposing of it as if he was the owner or subjecting the good to a destination other than the one agreed. For the existence of fraud deception is essential to set up the offense by causing the erroneous transfer of the possession to the perpetrator.¹⁶³

Germany

In Germany fraud is defined in Section 263 of the German Criminal Code (*Strafgesetzbuch-StGB*).¹⁶⁴ This offence is sanctioned by a maximum five-year term of imprisonment or a fine. This differs from

¹⁶² STS de 23 de abril de 1992

¹⁶³ SSTS 224/1998 of 26 February, 767/2000 of 3 May, 867/2000 of 29 July, 210/2002 of 15 February, 5/2003 of January 14, 84 /2005 February 1, 1210 /2005

¹⁶⁴ (1) Whosoever with the intent of obtaining for himself or a third person an unlawful material benefit damages the property of another by causing or maintaining an error by pretending false facts or by distorting or suppressing true facts shall be liable to imprisonment not exceeding five years or a fine.

(2) The attempt shall be punishable.

(3) In especially serious cases the penalty shall be imprisonment from six months to ten years. An especially serious case typically occurs if the offender

- a. acts on a commercial basis or as a member of a gang whose purpose is the continued commission of forgery or fraud;
- b. causes a major financial loss of or acts with the intent of placing a large number of persons in danger of financial loss by the continued commission of offences of fraud;
- c. places another person in financial hardship;
- d. abuses his powers or his position as a public official; or
- e. pretends that an insured event has happened after he or another have for this purpose set fire to an object of significant value or destroyed it, in whole or in part, through setting fire to it or caused the sinking or beaching of a ship.

(4) Section 243(2), section 247 and section 248a shall apply mutatis mutandis.

(5) Whosoever on a commercial basis commits fraud as a member of a gang, whose purpose is the continued commission of offences under sections 263 to 264 or sections 267 to 269 shall be liable to imprisonment from one to ten years, in less serious cases to imprisonment from six months to five years.

(6) The court may make a supervision order (section 68(1)).

the sanctions available in France, where both a term of imprisonment and a fine is imposed for breach of fraud legislation. Importantly, attempts to commit fraud are also punishable by virtue of Section 263 (2).

More severe sanctions are available – a six-month to 10-year term of imprisonment – if the fraud is deemed an “especially serious case” (organised crime, major loss, placing a large number of people at risk of loss, placing another person in financial need, abuse of position as public official).

In Germany the provision on fraud through false pretences (*Betrug*), uses the narrowing element of harm to property, which the German court decisions have significantly expanded by underscoring the economic impact of the offense as a guiding principle. German courts have adopted a wide concept of deceit including improper omissions. This broad conception of fraud through false pretences based on economic harm has however recently been significantly narrowed demanding danger to property or fraudulent inducement to contract.

The German concept also attempts to assure an objective basis for rational decision-making. This attempt has, however been reversed in great part through the inclusion of “internal” facts, such as intentions and beliefs. In the case of gross contributory fault on the part of the victim, the imposition of criminal liability for fraud is frequently considered inappropriate by German scholarship.

Most recently the German Federal Court of Justice has introduced a more restrictive interpretation of fraud and introduced a requirement that the perpetrator carry out a deception. A criminal liability for fraud pursuant to § 263 Section 1 of the Criminal Code requires that another person is deceived about the facts and is hence induced in error causing a reduction in his available assets.¹⁶⁵ It is irrelevant that the fact that the injured party could have detected the deception.¹⁶⁶ An act of deception is the misrepresentation or the distortion or suppression of true facts. Only the misrepresentation of facts falls within the meaning of § 263 StGB.¹⁶⁷

In contrast, mere value judgments, whether they are legal views, opinions, exaggerated, advertising recommendations or forecasts do not fall within the meaning of § 263 StGB.¹⁶⁸

In law and literature, it is generally accepted that besides by express declaration, including by deliberately untrue statements, a deception within the meaning of § 263, paragraph 1 of the Criminal Code also can be done implicitly, namely by misleading behaviour, that induces the other party to believe certain false representation even if the behaviour amounts to silence.¹⁶⁹

In order to amount to fraud, certain behaviour will require the direct intent to deceive the other party as deception cannot be simply a possible outcome.

Deferral fraud takes place when the author withholds or delays the ability of the creditor to claim his due by deceiving him and making promises about payments and personal guarantees. Such deferral fraud, however, is only punishable if the chances for the fulfilment of a claim decrease with the passage of time and thus the passing of time decreases the value of the credit.¹⁷⁰

(7) Section 43a and 73d shall apply if the offender acts as a member of a gang whose purpose is the continued commission of offences under sections 263 to 264 or sections 267 to 269. Section 73d shall also apply if the offender acts on a commercial basis.

¹⁶⁵ BGH, decision v. 13.1.2010

¹⁶⁶ BGH at sufficiently careful examination, ruling of 22.10.1986

¹⁶⁷ BGH, judgment dated 6.9.2001

¹⁶⁸ BGH, judgment dated 6.9.2001

¹⁶⁹ BGH, judgment dated 26.4.2001

¹⁷⁰ BGH, judgment dated 19.6.1951

In the case of a loan agreement, fraud may take place if the repayment is placed under circumstances that make it less secure when the creditor can satisfy his credit with difficulty, especially without the participation of the debtor.¹⁷¹

The extent of the financial loss can be determined by a comparison of the financial situation of the victim before and after the disposal.¹⁷² A fraud may take place when the deception affects the security of the recovery of a loan. In such instances to calculate the prejudice it may be necessary to assess the hypothetical amount that would have been realized had the deception not taken place.¹⁷³

If a financial loss cannot be proved, may be necessary to consider whether a credit fraud pursuant to § 265b StGB took place. Lending is a risky business. Therefore, the relevant concept of financial loss within the meaning of § 263 StGB in these situations is in the different assessment of the risk pertaining to the loan restitution.¹⁷⁴

If the goal of the deception was obtaining a loan, a fraud may take place if, as a result of the deception, a loan was given under a different calculation of the risk.¹⁷⁵ There is no fraud when the author has exclusively another goal such as “teaching a lesson” to the victim, while he only foresees as possible a pecuniary advantage.¹⁷⁶

A criminal liability for fraud pursuant to § 263 Section 1 of the Criminal Code requires that the perpetrator acted in the knowledge that the intended financial benefit is unlawful.¹⁷⁷

Fraud takes place when a person deceives another into parting with his money to make an investment that he falsely represent as being sound when he actually anticipates the possibility of a total loss.¹⁷⁸

Fraud and embezzlement are different in that in the case of the former, in the execution of an existing asset management duty the perpetrator has caused damage violating his duty to take care of the entrusted assets by deception.¹⁷⁹

The United Kingdom

The Fraud Act 2006 abolished a number of offences of deception under the Theft Acts 1968 notably obtaining (1) property, (2) a money transfer, (3) services, (4) a pecuniary advantage by deception, (5) evading liability by deception, and procuring the execution of a valuable security by deception.

These have been replaced by a general offence of fraud, which can be committed in three ways: by false representation, by failure to disclose information, or by abuse of position. If the defendant commits any one of these three wrongs, dishonestly, with intent to make a gain or cause a loss, he commits the offence.¹⁸⁰

Fraud by false representation

The core of the new offence of fraud is fraud by false representation which is committed where a person:

- i. dishonestly makes a false representation, and

¹⁷¹ BGH, judgment dated 5.5.2009

¹⁷² BGH, judgment dated 4.3.1999

¹⁷³ BGH, judgment dated 27.3.2003

¹⁷⁴ BGH, judgment dated 13.4.2012

¹⁷⁵ BGH, judgment dated 13.4.2012

¹⁷⁶ BGH, judgment dated 24.5.2011

¹⁷⁷ Federal Court of Justice, ruling of 09/19/1952

¹⁷⁸ cf. BGH, judgment dated 4.12.2002

¹⁷⁹ BGH, judgment dated 01.15.1991 - 5 StR 435/90

¹⁸⁰ The Fraud Act 2006 also replaced the offence of obtaining services by deception with that of obtaining services dishonestly. The gist of the offence is managing, by dishonesty, to obtain services without paying as required, with intent to avoid paying in full or in part.

- ii. intends, by making the representation –
 - a. to make a gain for himself or another, or
 - b. to cause loss to another or to expose another to a risk of loss.

Neither harm nor gain need actually accrue from the representation so long as this is the intention. It is not even necessary that the representee is taken in, or is otherwise influenced. Such formulation was designed to cope with technological scams, such as phishing, where unseen, fraudsters try to tempt individuals into parting with sensitive information by representing themselves to be their bank or other trusted custodian of their financial interests.

The *actus reus* requires the defendant to have made a false representation. A representation is defined as “false” if it is untrue or misleading and the person making it knows that it is, or might be, untrue or misleading. Actual knowledge that the representation might be untrue is required not awareness of a risk that it might be untrue.

For example, if the defendant is using his own credit card knowing that he has exceeded his credit limit then the false representation will be that he had authority to use the card and that the card issuer would honour the transaction (R v. Lambie [1982] A.C. 449 HL). If the documents are forged then the false representation would be that the document was genuine and would be honoured.

In the guidelines issued by the Crown Prosecution Service¹⁸¹ it is noted that the borderline between criminal and civil liability is likely to be an issue under this section. Prosecutors should bear in mind that the principle of caveat emptor applies and should consider whether civil proceedings or the regulatory regime that applies to advertising and other commercial activities might be more appropriate.

According to this principle, that is usually applied to transactions between business in United Kingdom, it is impossible for a buyer to recover damages for defects unless they have been actively concealed or the author made material misrepresentations, which is whether the dealer had an information advantage on the buyer that the buyer could not remove by showing due diligence.

The guidelines also stated that criminal law is not a suitable vehicle to regulate disputes such as disputes over ownership of property. Before a criminal charge can proceed the ownership of any property must be absolutely clear. If that ownership is in real dispute the criminal law should not be invoked until ownership has been established in the civil courts. However, circumstances will arise where the issues are clear and the offences are serious. If so, prosecution may be required in the public interest. Prosecutors should ensure that the state of affairs between the parties has not changed prior to any trial. This may affect both the public interest and the evidential test.

Duty to inform

A person is in breach of this section if he:

- i. dishonestly fails to disclose to another person information which he is under a legal duty to disclose, and
- ii. intends, by failing to disclose the information –
- iii. to make a gain for himself or another, or
- iv. to cause loss to another or to expose another to a risk of loss.

The concept of ‘legal duty’ is explained in the Law Commission’s Report on Fraud, which said: “...Such a duty may derive from statute (such as the provisions governing company prospectuses), from the fact that the transaction in question is one of the utmost good faith (such as a contract of insurance), from the express or implied terms of a contract, from the custom of a particular trade or

¹⁸¹ The *Fraud Act* (2006) is available at www.cps.gov.uk/

market, or from the existence of a fiduciary relationship between the parties (such as that of agent and principal).¹⁸²

For this purpose there is a legal duty to disclose information not only if the defendant's failure to disclose it gives the victim a cause of action for damages, but also if the law gives the victim a right to set aside any change in his or her legal position to which he or she may consent as a result of the non-disclosure.

According to the Crown Prosecution Service guidelines there is no requirement that the failure to disclose must relate to "material" or "relevant" information, nor is there any *de minimis* provision. If a Defendant disclosed 90% of what he was under a legal duty to disclose but failed to disclose the (possibly unimportant) remaining 10%, the *actus reus* of the offence could be complete. Under such circumstances the Defendant would have to rely on the absence of dishonesty. Such cases can be prosecuted under the Act if the public interest requires it, though such cases will be unusual.

It is no defence that the Defendant was ignorant of the existence of the duty, neither is it a defence in itself to claim inadvertence or incompetence. In that respect, the offence is one of strict liability. The defence must rely on an absence of dishonesty and the burden, of course, lies with the prosecutor.

According to the prosecution service guidelines prosecutors must be acutely aware of the public interest in such cases, bear in mind the relative standing of the parties and pay particular regard to any explanation for the failure given by the Defendant.

The Explanatory Notes to the Fraud Act provide the following examples of a breach of a legal duty:

- The failure of a solicitor to share vital information with a client in order to perpetrate a fraud upon that client;
- A person who intentionally failed to disclose information relating to his heart condition when making an application for life insurance.

Abuse of position

Section 4 provides as follows:

- i. A person is in breach of this section if he –
 - a. occupies a position in which he is expected to safeguard, or not to act against, the financial interests of another person,
 - b. dishonestly abuses that position, and
 - c. intends, by means of the abuse of that position –
 - to make a gain for himself or another, or
 - to cause loss to another or to expose another to a risk of loss.
- ii. A person may be regarded as having abused his position even though his conduct consisted of an omission rather than an act.

The thinking behind the section is that people in positions of trust can advance their own interests or damage the interests of others without having to 'enlist the victim's co-operation in order to secure the desired result.

The Law Commission made clear that it was envisaging a broader coverage than traditional fiduciary duties: "The essence of the kind of relationship which in our view should be a prerequisite of this form of the offence is that the victim has voluntarily put the defendant in a privileged position, by virtue of which the defendant is expected to safeguard the victim's financial interests or given power to damage those interests. Such an expectation to safeguard or power to damage may arise, for example, because the defendant is given authority to exercise discretion on the victim's behalf, or is given access to the victim's assets, premises, equipment or customers. In these cases the defendant

¹⁸² [Report on a reference under section 3\(1\)\(e\) of the Law Commissions Act 1965](http://lawcommission.justice.gov.uk/) is available at <http://lawcommission.justice.gov.uk/>

does not need to enlist the victim's further co-operation in order to secure the desired result, because the necessary co-operation has been given in advance. The necessary relationship will be present between trustee and beneficiary, director and company, professional person and client, agent and principal, employee and employer, or between partners. It may arise otherwise, for example within a family, or in the context of voluntary work, or in any context where the parties are not at arm's length. In nearly all cases where it arises, it will be recognised by the civil law as importing fiduciary duties, and any relationship that is so recognised will suffice. We see no reason, however, why the existence of such duties should be essential."

Examples of the type of conduct that would give rise to a charge under section 4 are:

- an employee of a software company who uses his position to clone software products with the intention of selling the products on his own behalf;
- an attorney who removes money from the grantor's accounts for his own use. The Power of Attorney allows him to do so but when excessive this will be capable of being an offence under Section 4;
- an employee who fails to take up the chance of a crucial contract in order that an associate or rival company can take it up instead;
- a trustee who dishonestly acts outside the terms of a trust deed in order to produce a gain or loss for himself or others;
- a director of a company who dishonestly makes use of knowledge gained as a director to make a personal gain;
- an employee who abuses his position in order to grant contracts or discounts to friends, relatives and associates.

3.6.2 Misuse of the criminal law in tax disputes

As financial crimes are growing in sophistication the same activity may violate a number of different laws. Different government agencies may be involved at various stages of tackling financial crimes, including the prevention, detection, investigation and prosecution of offences and the recovery of the proceeds of crime. Effective coordination and cooperation between different authorities are essential preconditions not only for an efficient prosecution of financial crimes such as fraud or tax evasion but also to ensure foreseeability in the application of the law (in application of the principle *nullum crimen sine lege*) and to avoid that an individual is effectively punished twice for the same crime (*non bis in idem*).

3.6.2.1 The Russian Federation

According to Article 140.1 of the Code of Criminal Procedure (Reasons and Grounds for the Institution of a Criminal Case) investigations into tax crimes under Article 198-199.2 of the Criminal Code can only be initiated on the basis of a report by the tax authorities. Such provision was introduced in 2009 under the presidency of Dmitry Medvedev following allegations of arbitrary criminal prosecutions in respect of certain tax violations. The provision introduced a mechanism ensuring a degree of coordination between the tax and prosecuting authorities.

Recently proposals for the amendment of this provision have been advanced: a draft law (No. 357559-6) is being discussed which would eliminate the requirement for the investigative authorities to obtain a report by the tax authorities as a precondition for the initiation of a criminal investigation into tax matters.¹⁸³

The proposed amendments have been supported by the investigative committee in the light of the considerable reductions in criminal cases which have been opened since 2009 and the need to exploit the potential of operational investigative authorities.

¹⁸³ [Главный смысл предполагаемых поправок – исключить из уголовно-процессуального кодекса специальное положение о допустимости возбуждения уголовных дел о "налоговых преступлениях" исключительно на основании представленного заключения органов ФНС]

The main objections to these amendments are based on the consideration that the decision over the initiation of an investigation into tax crimes should be based on the conclusion of specialised officials (the tax authorities), the risk of arbitrary and selective prosecutions and the need to protect the business community from an often arbitrary and unpredictable prosecution.

3.6.2.2 International standards

According to the ECtHR case law, normally tax proceedings fall outside the scope of Article 6: tax matters still form part of the hard core of public-authority prerogatives, with the public nature of the relationship between the taxpayer and the community remaining predominant (*Ferrazzini v. Italy* [GC], § 29). Article 6 does not extend to “pure” tax-assessment proceedings or to proceedings relating to interest for late payment, inasmuch as they are intended essentially to afford pecuniary compensation for damage to the tax authorities rather than to deter reoffending (*Mieg de Boofzheim v. France* (dec.)).

On the other hand upon certain conditions tax offences can fall within the ambit of the criminal head of Article 6: Article 6 has been held to apply to tax-surcharges proceedings, on the basis of the following elements:

- 1) that the law setting out the penalties covered all citizens in their capacity as taxpayers;
- 2) that the surcharge was not intended as pecuniary compensation for damage but essentially as a punishment to deter reoffending;
- 3) that it was imposed under a general rule with both a deterrent and a punitive purpose; and
- 4) that the surcharge was substantial (*Bendenoun v. France*). The criminal nature of the offence may suffice to render Article 6 applicable, notwithstanding the low amount of the tax surcharge (10% of the reassessed tax liability in *Jussila v. Finland* [GC], § 38). Similarly Article 6 under its criminal head has been held to apply to customs law (*Salabiaku v. France*), competition law (*Société Stenuit v. France*) and penalties imposed by a court with jurisdiction in financial matters (*Guisset v. France*).

In a series of cases against Sweden, the Court considered that both proceedings for tax surcharges and criminal proceedings for tax evasion were criminal in nature (*Manasson v. Sweden*, *Rosenquist v. Sweden*, *Storbråten and Haarvig v. Sweden*).

In this respect the applicability of the criminal limb of Article 6 to certain tax disputes may create the risk that the same individual (or company) is punished twice, in violation of Article 4 of protocol 7. Article 4 of Protocol No. 7 establishes the guarantee that no one shall be tried or punished for an offence of which he or she has already been finally convicted or acquitted (*Sergey Zolotukhin v. Russia*).

The importance of the coordination between state agencies in the fight against tax crimes was stressed in the OECD Recommendation of the Council to Facilitate Co-operation between Tax and Other Law Enforcement Authorities to Combat Serious Crimes of 14 October 2010 which invited member states to establish, in accordance with their legal systems, an effective legal and administrative framework and provide guidance to facilitate reporting by tax authorities of suspicions of serious crimes, including money laundering and terrorism financing, arising out of the performance of their duties, to the appropriate domestic law enforcement authorities.

3.6.2.3 *European practice in cooperation and coordination between tax, investigative, and prosecuting authorities*

The OECD has identified four models which demonstrate the various ways in which states coordinate the investigation of financial crimes and arrange inter-agency cooperation between their tax, investigative, and prosecution authorities.¹⁸⁴

Model 1: Applied in Germany, Switzerland, and the United Kingdom. Under this model the tax authority (e.g. in the UK HM Revenue and Customs) is responsible for directing and conducting investigations.

Model 2: Applied in Austria, Azerbaijan, Estonia, Hungary, Latvia, the Netherlands, Portugal, Serbia, Spain (but see also model 4 below), and Sweden. Investigations are conducted by the tax administration under the direction of the public prosecutor (or, as in Spain, an examining judge).

In Hungary, for example, even where the police or another investigating authority uncover evidence pertaining to a matter within the competence of the tax and customs administration, (e.g. tax crimes), they must inform the tax and customs administration that will, if appropriate, conduct an investigation.

Model 3: Applied in Greece and Turkey. Investigations are conducted by a specialist tax agency, distinct from the ordinary tax authority but under the supervision of the Ministry of Finance.

Model 4: Applied in Belgium, the Czech Republic, Denmark, Finland, France, Lithuania, Luxembourg, Norway, the Slovak Republic, Slovenia, and Spain (which has a hybrid model also following model 2). The police and/ or the public prosecutor are responsible for the conduct of investigations.

Italy does not apply any of the OECD's four models. "In Italy, responsibility for carrying out investigations into financial crimes, including tax crimes, sits with the *Guardia di Finanza*, which can conduct such investigations both independently and under the direction of the public prosecutor. The *Guardia di Finanza* is also able to carry out civil tax investigations and audits in accordance with its own administrative powers."¹⁸⁵

To enable the different agencies to work together for their mutual benefit at every stage of an investigation the OECD emphasises that the enhanced sharing of information is a primary means of cooperation and the coordination of activities. To this end there is a trend towards introducing obligations for the tax authorities, when conducting audits or similar examinations, to report any evidence or suspicions of serious crime to the police or prosecutor as appropriate.

In **Italy**, for example, if, in the course of their activities, the tax authorities uncover evidence of possible crimes, they must suspend any investigation of their own and immediately report their suspicions to the relevant judicial authority. In Norway, any reasonable suspicion, on the part of the tax authority, of a crime of a certain magnitude must be reported to the police. In Portugal, any public official who is aware that a crime is being committed is required to report it to the Public Prosecutor.

With regard to enhancing cooperation a further four primary models have been identified¹⁸⁶:

1. **Joint investigation teams** allow agencies with shared interests to cooperate during investigations. Joint investigation teams share information, and are able to access a greater spectrum of skills and experience as a result of including investigators with different backgrounds and training. Joint

¹⁸⁴ OECD (2013). *Effective inter-agency co-operation in fighting tax crimes and other financial crimes*, pp.13-14, available at www.oecd.org/

¹⁸⁵ Ibid., p. 33.

¹⁸⁶ Ibid., pp. 17-18.

investigations can avoid the duplication that often occurs when investigations are conducted in parallel. Allowing officials from each individual agency to focus on different aspects of an investigation, depending upon their experience and remit, can serve to increase overall efficiency.

The **Czech Republic**, for example, operates an inter-departmental agreement allowing the Ministry of Finance and the police to establish ad hoc joint investigation teams for individual investigations. These inter-agency investigations are overseen by a permanent joint special unit responsible for organisation and co-ordination. To date, all such joint investigations have involved the police and the customs administration (responsible for investigating the alleged evasion of VAT and consumer taxes) although, in theory, the tax administration could also play a part (there are, however, tight restrictions in place regarding the sharing of information pertaining to income and capital taxes which may limit the involvement of the Czech tax administration).

In **Finland**, joint investigations teams, or taskforces, have been created with members of the police, customs, and border agencies. In Hungary joint investigation agreements must be approved by the public prosecutor, but, where an official joint investigation is deemed unnecessary, an agent with relevant skills or experience can be seconded to assist another authority in its investigation. Slovenia has, since 2009, formed multi-agency investigatory teams supervised by the State Prosecutor.

2. **Inter-agency “intelligence centres”** form a centralised information gathering and analysis operation for the use of multiple agencies. They may focus on a specific geographic area or type of criminal activity, or be employed for general information sharing. Intelligence centres both conduct original analyses based on primary research and collate information provided to them by the participating agencies. The value of centralisation is in the developments of specialised systems as well as the knowledge and experience that can be acquired by agents assigned to the centre. Budgetary savings may also be achieved, as the costs of intelligence gathering can be shared between the participating agencies.

Finland, for example, has created a “Grey Economy Information Unit” (GEIU) within its tax administration that is intended to cooperate with fellow government agencies in combating the “grey economy”. The GEIU is entitled to receive all necessary information held by other authorities even where that information would normally be restricted for reasons of secrecy. The GEIU prepares “compliance reports” on behalf of its partner agencies that document the business activities, financial status et al of individuals and organisations.

3. **Secondments and the co-location of personnel** are an effective way of transferring skills and allowing personnel to build contacts with other agencies. Seconded officials can share their skills, experience and specialist knowledge while participating directly in the work of the host agency.

The most common use of this model involves seconding agents of the tax authority to the police and other law enforcement agencies so that the police can benefit from the tax agent’s financial expertise. Examples can be found in Belgium (Central Office for the Prevention of Organised Economic and Financial Crime); Hungary (Corruption and Counter Economic Crime Unit); Ireland (Criminal Assets Bureau); the Netherlands (FIOD); Norway; Portugal; and the UK (Serious Organised Crime Agency).

France has a successful record of facilitating cooperating between the police and the tax authorities. The *Brigade nationale d’enquêtes économiques* (BNEE) comprises approximately 50 tax inspectors who are assigned to work as liaisons with the judicial police for the investigation of financial crimes. The *Brigade nationale de répression de la délinquance fiscale* (BNRDF) is a judicial police unit tasked with investigating the most serious tax frauds. It places tax inspectors at the heart of such cases and allows their knowledge of financial matters to be combined with the procedural experience of the judicial police.

In **Italy** it is more common to second agents with the necessary experience of tax or customs issues to the office of the public prosecutor. In addition to creating the desired pool of skills and expertise it has

also fostered a better working relationship between the participating agencies. A similar approach is applied in Austria and Belgium.

4. **Other models**, including such strategies as the sharing of databases; the production and dissemination of strategic intelligence reports (e.g. newsletters and intelligence briefs); joint committees for the coordination of policy in areas of shared responsibility; and inter-agency meetings and training sessions designed to share information on trends in financial crime and general best practice.

Austria, for example, has established a bribery and corruption working group that includes agents from both the tax administration and the public prosecutor's office. The group holds regular meetings with other agencies and organises training sessions in order to foster personal contacts and aid in the sharing of information. Germany operates a similar system that involves liaison between tax, customs and criminal investigation departments at both a general level and when cooperating on specific cases.

3.6.3 Conclusions

The initiation of criminal proceedings is commonly used as one of the mechanisms for the resolution of civil disputes in the Russian Federation. The initiation of criminal proceedings on the basis of an application by one participant or a group of participants of a business partnership against another participant (or group of participants) of the same partnership results in significant psychological and judicial pressure (reaching as far as detention) on one of the parties in what may be essentially a civil dispute.

The fight against economic crime requires the existence of a coherent and comprehensible set of standards easy to understand for those involved. The absence of which may lead to violations of Article 7 of the European Convention on Human Rights (no punishment without law) as legal provisions may not be sufficiently foreseeable in their application.

Arbitrary interpretation of Article 159 of the Criminal Code on fraud, criminalisation under such provision of behaviours that effectively amount to contractual non-compliance are among the main manifestations of abuses affecting the business community in Russia. While abuse of Article 159 may be partly explained with intentional or negligent disregard of its provisions, it appears that the introduction in the legal provision of further requirements may be effective in limiting the initiation of unfounded criminal cases against entrepreneurs.

While the Russian Criminal Code's definition describes fraud as "the stealing of other people's property by deception or breach of trust", (and fraud in the context of entrepreneurial activities is interpreted as deliberate default on contractual obligations) the countries examined have introduced, by legislative means or judicial interpretation, further criteria that restrict the applicability of fraud.

In France deception must have taken place in specific ways: by using a false name or fictitious capacity, by abusing a genuine capacity or by means of an unlawful manoeuvre. The *Cour de Cassation* has consistently required that, to qualify as fraud, fraudulent machinations do not simply amount to false representation but entail the combination of facts, arrangement of schemes, organisation of tricks, a staging giving credit to a lie. The existence of a lie is not considered as sufficient to engage criminal responsibility. Similarly the Italian legislator has required for the existence of criminal responsibility, the use of trickery (*artifizi o raggiri*). In Spain the deception must be sufficient to induce a mistake as accent is made on the victim of the fraud and its ability to detect it. In its case law the Spanish Supreme Court has clarified the boundaries between civil and criminal fraud, stating for example that the mere intentional default on contractual obligation is not sufficient to give rise to criminal responsibility.

In Germany fraud by omission has been criminalised only when the perpetrator had a duty to inform the other party. In United Kingdom investigative authorities have been warned against commencing a criminal case when there is no clarity as to the ownership of property.

In respect of misuse of the criminal law in tax disputes, it should be noted that in many jurisdictions the agencies charged with the collection of taxation, the investigation of crimes, and the prosecution of offences can comprise three distinct authorities. This can lead to a lack of coordination and general inefficiencies that can seriously hamper investigation and prosecution. There can even be repercussions for private individuals and organisations who may find that their rights are affected by seemingly arbitrary prosecutions and repeated criminal charges.

The introduction of even the most basic mechanisms aimed at enhancing cooperation between state agencies via the sharing of information and other resources (such as experienced agents) can serve to enhance the performance of the participating authorities thereby achieving mutual benefits.

It is suggested that adopting methods of inter-agency cooperation such as the secondment of tax officers to the police and prosecutor's office; the creation of joint task forces specialising in the investigation of tax crimes; and the creation of joint intelligence centres focused on the provision of qualified expertise for both individual cases under investigation and general issues may allow the Russian authorities to overcome the limitations of a model based on a rigid distinction of roles and functions between the tax authorities and the investigative and prosecuting authorities.

4 CIVIL PROCEDURE

4.1 Procedural abuse

A type of misuse that can be used against business competitors or partners is the submission of knowingly ungrounded civil claims with the sole purpose of causing inconvenience or other harm to the defendant. Other types of bad faith behaviour in litigation may be repeated frivolous requests or counterclaims during a lawsuit, or attempts to deceive the court. Such means include the creation and presentation of false evidence in civil litigation, the use of civil litigation to obtain information about the target company or to harass the target and tie up its business in order to make it more willing to sell out to the “raider” at below market price.¹⁸⁷

4.1.1 The Russian Federation

It is not uncommon that shareholders involved in corporate conflict or so called raiders trying to take control over assets of a target company abuse their procedural rights to paralyse the target’s ability to defend itself. For example, raiders often file a frivolous lawsuit in order to obtain a court judgment temporarily restricting the voting power of other shares, thus giving the raiders a temporary majority, which they then use to change the board of directors. Once the raiders gain a temporary majority, they make a supplementary stock issue in order to dilute the percentage held by the other shareholders and solidify the raiders' hold on the company.¹⁸⁸

Even when they do not resort to corruption of judges, judges may end up being unwitting tools in the hands of shareholders involved in corporate conflict and willing to abuse their procedural rights.

Conversely the adoption of interlocutory injunctions by shareholders who are trying to protect themselves against unlawful corporate takeovers may prove impossible, especially when the raider is trying to manipulate the shareholders’ assemblies to change the company’s management, unlawfully squeeze out the other shareholders and so on.

For example, following the resolution of the Supreme Arbitrazh Court No 11 of the 9th of July 2003 stating that interlocutory injunctions cannot be adopted in respect of shareholders assemblies (but only in respect of specific issues which have been put on the agenda and only if they are under dispute or strictly connected to the dispute) malicious plaintiffs resorted to the calling of several assemblies of shareholders in a single day, each with only one issue in the agenda: in this way it has been possible to avoid the application of injunctions as they would be considered in violation of the resolution of the Supreme Arbitrazh Court.¹⁸⁹

Another technique is to have proxy minority shareholders claim damages against majority shareholders. Once the court has ruled for the claimant, the defendant’s stake may be seized and sold in a rigged auction, transferring the stake to the raider, who controls the proxy minority shareholders.¹⁹⁰ In other cases, once it has been established that a target company is indebted (often through the unlawful acquisition of financial information), corporate raiders acquire the debts or shares in the target company, and start filing several malicious lawsuits both before regional courts

¹⁸⁷ Thomas Firestone, *Criminal Corporate Raiding in Russia*, *The International Lawyer* Vol. 42, No. 4 (WINTER 2008), pp. 1207-1229

¹⁸⁸ *Ibid.*

¹⁸⁹ Razdyakonov ES (2008) *Abuse of shareholders the right to apply for interim measures: problems and ways of improving legislation* [Злоупотребление акционерами правом на применение обеспечительных мер: проблемы и пути совершенствования законодательства] Автор: Раздьяконов Е.С., к.ю.н. (г.Екатеринбург) Источник: журнал Арбитражный и гражданский процесс. 2008. № 10. С.32-36], available at <http://statut.org>

¹⁹⁰ A.Settles (2009), *Evolving Corruption: Hostile Takeovers, Corporate Raiding, and Company Capture in Russia*, Centre for International Private Enterprise, available at : www.cipe.org/

and the court where the company is located. This type of initiative is used to incapacitate and harass the target company.¹⁹¹

4.1.2 Council of Europe member states: Procedural abuses, procedural crimes and vexatious litigants

Measures have been introduced across Europe to identify, prevent and punish behaviour that does not represent the exercise in good faith of such rights as access to court and defence rights. These regulations are characterised by the need to balance the punishment of the illegitimate conduct of parties to proceedings with respect for their fundamental rights.

In *Golder v. United Kingdom* the European Court of Human Rights (ECtHR) stated that the right of access to a court is implicitly guaranteed by Article 6 of the European Convention.¹⁹² This right is not, however, absolute. The Court in *Golder* accepted that 'implied' limitations on the right of access exist. State parties are allowed a certain margin of appreciation as long as a limitation does not restrict the access to a court in such a way that the very essence of the right is impaired. Furthermore, the intended purpose of the imposed limitations needs to be justified and limitations should be proportionate.¹⁹³

The ECtHR has examined various limitations on the right of access to a court. The imposition of a court fee prior to the commencement of legal proceedings is in principle not problematic for Convention purposes, unless the amount is disproportionate.¹⁹⁴ Equally unproblematic are limitations created by certain procedural bars. In cases where a party to national proceedings does not observe certain procedural rules resulting in the discontinuance or inadmissibility of the case, it will in general be difficult to lodge a complaint in Strasbourg successfully.¹⁹⁵ Neither is the Convention violated in cases where national law provides for appellate proceedings, which are, however, subject to a system of leave to appeal¹⁹⁶ or to the imposition of a 'civil fine' for making an abusive appeal to a higher court.¹⁹⁷ Nor does the right of access to a court include an obligation for a national judge to refer the case and ask for a preliminary ruling.¹⁹⁸

The Court has also accepted various limitations dependant on the nature of the litigant. Limitations on access for minors¹⁹⁹, persons of unsound mind²⁰⁰, bankrupts²⁰¹ and vexatious litigants²⁰² have all been accepted by the Court.

¹⁹¹ [Бобков Алексей Владимирович Криминальное банкротство: криминологическая характеристика и противодействие. Автореферат диссертации на соискание ученой степени кандидата юридических наук (Министерство внутренних дел Российской Федерации Омская академия)]

¹⁹² "In civil matters one can scarcely conceive of the rule of law without there being a possibility of having access to the courts [...] It would be inconceivable, in the opinion of the Court, that Article 6 par. 1 should describe in detail the procedural guarantees afforded to parties in a pending lawsuit and should not first protect that which alone makes it in fact possible to benefit from such guarantees, that is, access to a court. The fair, public and expeditious characteristics of judicial proceedings are of no value at all if there are no judicial proceedings. ECHR, 21 February 1975, *Golder v. United Kingdom*, §§37-39).

¹⁹³ "Certainly, the right of access to the courts is not absolute but may be subject to limitations; these are permitted by implication since the right of access 'by its very nature calls for regulation by the State, regulation which may vary in time and in place according to the needs and resources of the community and of the individuals' [...] In laying down such regulation, the Contracting States enjoy a certain margin of appreciation. Whilst the final decision as to observance of the Convention's requirements rests with the Court, it is no part of the Court's function to substitute for the assessment of the national authorities any other assessment of what might be the best policy in this field" (ECHR, 28 May 1985, *Ashingdane v. United Kingdom*, §57).

¹⁹⁴ ECHR, 13 July 1995, *Tolstoy v. United Kingdom*.

¹⁹⁵ For example, a requirement that an appeal be lodged by a lawyer (and not the applicant) will be permitted (ECHR, November 1986, *Gillow v. United Kingdom* (Series A-109), §69).

¹⁹⁶ ECHR, 29 October 1991, *Helmets v. Sweden* (Series A-212-A), §36.

¹⁹⁷ EComHR, 6 October 1982, *X. v. Sweden* (appl. no. 9707/82; D&R 1982, 223).

¹⁹⁸ ECHR, 22 June 2000, *Coëme v. Belgium* (appl. no. 32492/96).

¹⁹⁹ EComHR, 4 May 1987, *M. v. United Kingdom* (appl. no. 12040/86; D&R 52, 269). See also ECHR, 21 February 1975, *Golder v. United Kingdom* (Series A-18), §39 and the Separate Opinion of Judge Fitzmaurice in the *Golder* case.

²⁰⁰ ECHR, 24 October 1979, *Winterwer v. Netherlands* (Series A-33), §75.

²⁰¹ EComHR, 4 May 1987, *M. v. United Kingdom* (appl. no. 12040/86; D&R 52, 269).

Limitations on the right to seize courts may also stem from Article 17 of the Convention which prohibits the abuse of rights. In the cases of *Refah Partissi v. Turkey* and *Hizb Ut-Tahrir and Others v. Germany* (no. 31098/08) the Court held that, under Article 17, it was impossible to derive from the Convention a right to engage in an activity aimed at destroying any of the rights and freedoms set forth in the Convention.

Italy

In Italy, until 2007, the issue of procedural abuse was mainly a theoretical one. Article 88 of the Code of Civil Proceedings did impose on the parties to proceedings a duty to behave in good faith, but had not led to any practical consequences.

In 2007 the Italian Supreme Court ruled that the conduct of a creditor who had repeatedly seized the courts in order to obtain partial payments of his credit when he had unilaterally and arbitrarily split the obligation of his debtor into several partial ones, was in bad faith. The Court argued that such behaviour, when the creditor could have seized the courts for the payment of the whole debt, was in violation of rules that imposed an obligation of good faith in the execution of the contract. The duty of good faith, in the opinion of the Court, extended to judicial actions based on the contract when the lawsuit was aimed at obtaining the execution of said contract. In so acting the creditor had unfairly worsened the contractual position of his debtor and had been unable to otherwise justify his choices in respect of his judicial strategy.²⁰³

Similarly the request of a plaintiff, asking the Court to rule on its jurisdiction in an attempt to delay the resolution of frivolous claim brought by the plaintiff held to be abusive. The Court noted that such a request had no other goal than to obtain a suspension of the trial that the plaintiff had initiated.²⁰⁴

The Court held that, in such circumstances, the judge had an obligation to refer the violation to the plaintiff's legal representative's Bar Chamber's disciplinary body pursuant to Article 88 of the Code of Civil Procedure.

In subsequent decisions the Supreme Court also considered as abusive the behaviour of a defendant who filed a frivolous counterclaim against a plaintiff with the sole goal of having the judge replaced²⁰⁵; as was the behaviour of a plaintiff who had filed other lawsuits against fictitious co-defendants with the sole goal of removing the competence of the judge and having the case transferred to another tribunal.²⁰⁶

In these cases the Supreme Court held that among the obligations of a court, when deciding whether it had competence/jurisdiction over a case, and where the plaintiff had a choice of which court to seize, was verifying whether the plaintiff was motivated by having the lawsuit removed from another court.

²⁰² EComHR, 2 December 1985, *H. v. United Kingdom* (appl. no. 11559/85; D&R 45, 281) in which the applicant needed judicial permission to bring a case because he was subject to a 'vexatious litigant's order'.

²⁰³ Cass., sez. un., 15 novembre 2007 n. 23726

²⁰⁴ Cass., sez. un., 3 novembre 1986 n. 6420

²⁰⁵ V. infatti su questo aspetto Cass. 16 gennaio 1993 n. 530, per la quale "Il giudice cui sia rivolta la domanda di accertamento con efficacia di giudicato di una questione pregiudiziale deve appurare se sussista un interesse effettivo in capo all'attore, tale da travalicare l'interesse relativo al giudizio in corso, nel senso che la questione pregiudiziale sia idonea ad influire anche su liti diverse, pendenti o di prevedibile insorgenza, fra le stesse parti, o anche su altri rapporti ed altri soggetti". *Conformi v. Cass.* 12 luglio 2005 n. 14578; *Cass.* 8 maggio 2004 n. 8781; *Cass. sez. un.*, 14 novembre 2003 n. 17208; *Cass.* 10 luglio 2002 n. 10039; *Cass.* 6 marzo 2001 n. 3248; *Cass.* 5 agosto 1998 n. 7691.

²⁰⁶ V. infatti *Cass.* 10 maggio 2010 n. 11314, per la quale "La deroga alla competenza territoriale determinata dal cumulo di cause connesse, proposte contro più persone e radicate presso il giudice del foro generale di uno dei convenuti, non trova.

Based on the Supreme Court's case law, the doctrine is that bad faith behaviour does not only include actions aimed at preventing the application of provisions to ensure the application of the adversarial principle, but also behaviour aimed at interfering or delaying the course of justice.

Such behaviour has been defined as including: making false statements; delays in the submission of documents; and the request for a postponement of a hearing based on the false statement that such a request had already been agreed with the other party.

In dealing with conduct that is deceitful, dilatory, redundant or otherwise contrary to "the standard of care of legal professionals" the Supreme Court allows a judge to refuse a lawyer's petition in order to avoid "an unnecessary expenditure of activity and superfluous procedural formalities".

Pursuant to Article 88 of the Code of Civil Procedure, in cases of such bad faith behaviour, the judge is permitted to adopt disciplinary or procedural sanctions. The judge may take into consideration the behaviour of the parties in assessing evidence (Article 116) or he can adopt directions to ensure that proceedings are fair (Article 175). Pursuant to the Article 404 creditors of a party to civil proceedings are allowed to file an "opposition" to a judicial decision if the judicial decision was adopted as a result of fraud or collusive litigation.

Where a judicial decision is adopted as a result of the bad faith behaviour or abusive behaviour of a party to civil proceedings, it is also possible to set aside the decision or to impose on the party acting in bad faith the payment of judicial expenses even if the party did not lose the case (Article 92).

Judges are also obliged to refer misconduct by a party's legal representatives to his bar chamber who should verify whether ethical rules have been breached and if so, must apply disciplinary sanctions.

Pursuant to the Article 96 the judge, upon a request from the other party to proceedings, can also impose on the party who acted in bad faith or with gross negligence the payment of judicial costs and damages.

In decision n. 17485/2011 the Supreme Court ruled that in cases of malicious litigation the other party can obtain the compensation of damages without having to provide concrete evidence of the damage suffered in consideration that the notion of damages should not cover only material damages but also the effects of having to deal with being forced to counter the opponent's vexatious initiative and other discomforts faced as a result of this behaviour.

In 2011 the Supreme Court ruled that an abuse of process consists of a defect of the function, or a circumvention of the function, of the law, and is realized when a law or procedural power is exercised for purposes other than those that serve to protect a defendant's interests. In such cases the defendant cannot claim the protection of interests that have not been affected and that were not actually sought.²⁰⁷

Pursuant to this decision the Court excluded a judge who had refused to consider a disproportionate number of clearly unfounded petitions filed by a defendant who had also tried to delay the trial by continually changing his legal representatives.

In the criminal law, the Court held that maliciously instituting and pursuing (or causing to be instituted or pursued) a criminal action, that is brought without probable cause and dismissed in favour of the victim of the malicious prosecution, entails the obligation to pay civil damages to the victim only in cases where such behaviour is slanderous²⁰⁸

²⁰⁷ Cass. Sez. Un., sentenza n. 155 del 29/09/2011 in Ced Cass. Rv. 251496

²⁰⁸ Cass. civ., 20.10.2003, n. 15646

Spain

Procedural fraud in Spain has existed in its current form since 1995 and is defined as an attack against the judiciary.²⁰⁹ It is a crime punishable by pecuniary fines and up to six years in prison.

Organic Law 5/2010 further defines procedural fraud in Spain. In the decision of the supreme court 1015/2009 of 28 October, procedural fraud was described as a “deception that uses proceedings as a medium /tool, or behaviour that in the framework of proceedings seeks to obtain a profit by causing harm to others, through an unfair judicial decision caused by misleading the judge, it being necessary that the behaviour made in preparation and execution of such behaviour, has the ability to induce the judge into reasonable error”²¹⁰.

In the decisions 76/2012, of 15 February, 332/2012, of 30 April and 366 /2012, of 3 May, the supreme court further defined procedural fraud as “those devices deployed in the course of proceedings directly aimed at the judge, with the goal of misleading him into passing an unfair decision and causing harm to a person with the consequent undue profit to another”.

According to the decision of the supreme court of 9 May 2003, procedural fraud is an aggravated form of fraud because it represents an attack on the legal certainty represented by the court which is used as a tool for fraudulent actions.

As stated by the Supreme Court decisions 266/2011, of 25 March, the deception must be capable of “misleading” a judge in the form of overcoming their professionalism and any procedural safeguards²¹¹ although two qualifications apply:

1. Whether behaviour has been capable of misleading a judge must be assessed on a case by case basis, and the professional qualifications of a judge set a high standard in determining whether a judge was truly deceived;
2. If the mistake of the judge concerns the interpretation of the law, the error will only be attributable to his own interpretive action irrespective of the conduct of the parties and any interpretations submitted by them.

Strictly speaking in procedural fraud the person who is deceived (the judge) is different from the individual who eventually suffers the prejudice of the conduct (one of the parties to the case). Such cases are known as “proper” procedural fraud. The affected party may, however, also be induced to desist, give up, agree to a transaction or otherwise change his procedural strategy in a way that will be more favourable to the other party as the result of certain “tricks” (usually false evidence or the simulation of a contract). This is known as “improper” procedural fraud.

Improper procedural fraud is an aggravating factor that has been recognised by the Supreme Court²¹² on the ground that such deception not only affects the private parties but also the functioning of the justice system which requires an even more sophisticated form of trickery to mislead the professional competence of the judge.

Where procedural fraud has taken place and achieved its effects it is possible to obtain a suspension or annulment of a specific decision.

The Spanish Supreme Court²¹³ has also distinguished between procedural and “ordinary fraud”. The commission of the procedural fraud is often accompanied by the commission of other crimes, such as

²⁰⁹ SSTS 271 /1997 of 4 March and 457/2002, of 14 March

²¹⁰ This interpretation has been confirmed by the judicial decisions 35/2010 of 4 February and 124/2011 of 28 February.

²¹¹ STS of 5 December 2005

²¹² Decision 794/1997 of 30 September

²¹³ Decision 128/2008, of 28 February

forgery, perjury or false accusation. Thus, in many cases, forgery becomes the necessary tool for achieving procedural fraud. Spanish criminal law condemns both offenses as causing prejudice to the victim, under the rules of Article 77 of the Penal Code.

The Supreme Court has held that the mere concealment of claims (*ocultacion de alegaciones*) is not enough for a finding of procedural fraud. Such behaviour may, nevertheless, be considered contrary to good faith, and may have negative consequences for the party in adjudicating costs and expenses in the process, but this is outside the criminal law.

France

Escroquerie au jugement

In France while filing a court lawsuit is an acknowledged right for all litigants, limitations are placed against both the abuse of this right and of fraud. Abuse of the right “to sue” is punished through a civil penalty and damages against the applicant.

Deceit and the deception of judges is a criminal offense (fraud to the judgment or *escroquerie au jugement*) which has been defined in case law. Procedural fraud is defined as misleading a judge in order to obtain a title/ determination that will necessarily affect the fortune/ economic sphere of the convicted person.

Pursuant to Article 313-1 of the Criminal Code, a procedural fraud is committed either by the use of a false name or a false capacity, or by the abuse of a true quality, or by the use of fraudulent machinations, misleading a physical or legal person to induce him, to his prejudice or to the injury of a third party to deliver funds, securities or any property, provide a service or to consent to an act or discharge an obligation. The fraud is punishable by five years' imprisonment and a € 375,000 fine.

Procedural fraud is different from an abuse of the right “to sue” (malicious prosecution). The courts have defined such an abuse as a legal action brought in bad faith, knowing it is doomed to failure or to harm the opponent. Similarly the case law has included within this conduct a complaint filed against a judicial decision, appeal or cassation considered dilatory or abusive.

The Supreme Court has stated that, as filing a lawsuit is the exercise of a right, if the litigant makes false allegations, even repeatedly, it will not be enough to consider his behaviour as constituting procedural fraud on itself. Rather it will be necessary to consider other conditions such as the use of manoeuvres/ machinations by knowingly misleading a judge to get a favourable decision on his claim, either by producing false documents or using false testimony.

The court also held that the means used are central to determining whether a crime has been committed: “There is no fraud in the submission, in support of a lawsuit, of a document the validity/meaning and evidentiary value of which is precisely the task of the court to determine.”²¹⁴

“It is an attempt of procedural fraud the fact that a party knowingly submits a false legal document intended to deceive the judge and who may if the plot is not thwarted, make a decision likely to prejudice the interests of the opponent.”²¹⁵

False statements, even where repeated, are not sufficient to constitute the crime of fraud unless they are accompanied by an external fact or behaviour capable of misleading. Such external elements (machinations, false documents, false representation) should be brought in bad faith, through the use of the judiciary in order to obtain a decision of the for the spoliation opponent.²¹⁶

The guilty intention, necessary for the existence of the fraud, requires that one of the parties has knowingly and successfully committed the fraudulent acts in order to deceive the judges.

²¹⁴ Crim 24 June 1970

²¹⁵ Crim 26 March 1998, See also Crim. 14 March 1972

²¹⁶ Crim April 20, 2005, appeal No. : 04-84828

Sanctions against procedural fraud: civil and criminal sanctions

Civil liability for procedural fraud is applied on the basis of Article 1382 of the Civil Code. Victims of procedural fraud must file a complaint with the prosecutor for the high court or with the police within three years of the judicial decision adopted on the basis of fraud. Victims can claim compensation for the damage that has been caused. The victim may become a civil party to the criminal court to make a request for damages as compensation for financial loss and moral injury.

Anyone who abuses the right to sue is exposed to the application of penalties, both under penalty of civil fine and damages for the financial and moral damage caused, and also criminal prosecution. Thus, in case of acquittal, or nonsuit, nothing will prevent the criminal court seeking criminal sanctions or imposing other penalties.

Pursuant to Article 32-1 of the Code of Civil Procedure, the judge can adopt sanctions against those responsible for procedural fraud when their degree of fault involves the “degeneration into abuse of the right to sue for justice”.

Pursuant to the provisions in the Code of Civil Procedure the judge is the arbiter and guarantor of the rules of procedure governing the administration of the evidence before him; he can draw consequences, both civil (section 1) and criminal (section 2), for breaches committed by the parties.

The Supreme Court case law defines the conditions for civil compensation in the following way: “The exercise of a legal action is, in principle, a right, and if it degenerates into abuse it may give rise to the right to compensation, if it is an act of malice or bad faith, or if it is an error equivalent to fraud.” A sanction, of up to 3000 Euros, may be applied where the judge believes that the plaintiff's action was unreasonable or interfered with the rights of the other party. The sanction is up to 15000 Euros in cases of malicious prosecution. The judge may impose a civil penalty only against the plaintiff or petitioner and not against the defendant, which will be determined without prejudice to any damages that may be granted.

The criminal law punishes conduct that interferes with the fairness of the evidence produced in court. It also seeks to suppress attempts to deceive the judge in order to cause harm to others. Special provisions punish intentional alteration of written documents, witness statements, and physical evidence presented in court.

- Written evidence: Article 441-1 of the Criminal Code defines and punishes the use of forged documents that have “the purpose, or may have the effect, of establishing proof of a right or an act having legal consequences”.
- Witness statements: Article 434-11 of the Criminal Code, which punishes the refusal to testify in favour of an innocent, is limited to a specific number of individuals listed in the article and has been seldom used.
- False testimony: Article 434-13 is applied more frequently. False testimony made under oath before any court of law or before a judicial police officer is punishable by five years' imprisonment and a fine of €75,000. A false witness is, however, exempt from penalty where he retracts his testimony spontaneously before the decision terminating the procedure has been made by the judicial investigating authority or the court of trial.
- Article 434-15 penalizes bribery, even without effect, that is to say: the use of promises, offers, presents, pressures, threats, acts of violence, manoeuvres or tricks in the course of proceedings or in respect of a claim or defence in court to persuade others to make or deliver a statement, declaration or false affidavit, or to abstain from making a statement, declaration or affidavit, is punishable by three years' imprisonment and a fine of €45,000, even where the bribery was ineffective.

- **Physical Evidence:** Article 434-4 of the Penal Code defines and punishes the destruction of material evidence “where it is done in order to obstruct the discovery of the truth”. A penalty of three years' imprisonment and a fine of €45,000 applies both to: modifying the scene of a felony or a misdemeanour either by the alteration, falsification or obliteration of clues or evidence, or by bringing, removing or suppressing any given article; and to destroying, purloining, concealing or altering a private or public document or an article liable to facilitate the discovery of a felony or a misdemeanour, the search for evidence or the conviction of the guilty party.

The United Kingdom

In the UK vexatious litigation has been a part of English and Scots law since the 1890s. It is defined as any legal action which is brought, regardless of its merits, solely to harass or subdue an adversary. It may take the form of a primary frivolous lawsuit or may be the repetitive, burdensome, and unwarranted filing of meritless motions in a matter which is otherwise a meritorious cause of action.

Filing vexatious litigation is considered an abuse of the judicial process and may result in sanctions against the offender. The UK Courts have their own powers to deal with unmeritorious claims and applications. They may strike out the action as an abuse of process of the Court; or they may of their own motion, or on request by a party to the proceedings, issue various orders restricting the litigant's ability to continue with further applications or claims.

A single action, even a frivolous one, is usually not enough to raise a litigant to the level of being declared vexatious but repeated and severe instances by a single lawyer or firm can result in eventual disbarment.

In England and Wales the Attorney General, who has a public interest function in preserving the administration of justice, can make an application to the Divisional Court pursuant to Section 42 of the Senior Courts Act 1981, seeking a Civil Proceedings Order or a Criminal Proceedings Order, for a subject to be declared a vexatious litigant. If the vexatious activity has been in both Civil and Criminal courts, the Attorney General may seek an All Proceedings Order under Section 42 which covers both civil and criminal proceedings. The effect of such orders is to restrict the individual's ability to bring further claims or applications within existing claims without leave of a High Court Judge/ Employment Appeal Tribunal (EAT) as appropriate.

Vexatious litigation proceedings brought under these Acts can only be brought by HM Attorney General and the decision to bring such actions are taken only after a full investigation by the Treasury Solicitor's Department into the individual's activity and where one of the Law Officers (the Attorney General or Solicitor General) determines that it would be in the public interest to make the application.

In determining whether a litigant is likely to fall within this category and, therefore, be considered an appropriate candidate for an application, one of the Law Officers will look at the number and type of proceedings, the individual's conduct and character displayed during those proceedings, the degree of hardship suffered by complainants and the likelihood of unmeritorious litigation continuing.

In practice, the Attorney General is unlikely to intervene unless at least six separate claims have been commenced by the subject which have been unsuccessful or struck out. This figure, however, is not absolute and each case will be looked at on its own merits

If the Attorney General decides that the application is warranted, the Treasury Solicitor will make an application to the Divisional Court or the EAT (as appropriate).

The Civil Restraint Order (CRO) is a remedy for individuals who have been subjected to two or more unmeritorious claims or applications made against them by the same person relating to the same or

similar matters. It is relatively quick to achieve, is granted for a period up to two years, preventing the subject of it from taking certain steps as specified in the Order, without first obtaining leave of a designated Judge. CROs do not require the intervention of the Attorney General (see Civil Procedure Rules (CPR) Part 3.11, practice direction 3c).

4.1.3 Conclusions

European countries employ various means to identify, prevent and punish behaviour that does not represent the good faith exercise of such rights as access to court and defence rights. Legitimate limitations on these rights include the imposition of court fees prior to the commencement of legal proceedings, a system of the leave to appeal or imposition of a civil fine for making an abusive appeal to a higher court. Acceptable are also limitations in view of the nature of the litigant, e.g. restrictions on the ability of vexatious litigants to bring applications and claims. Grave forms of procedural abuses are addressed through fines, imposition of liability for damages or criminal sanctions.

4.2 Interlocutory injunctions

Various aspects of court procedures may be misused in the context of corporate conflicts. The misuse may be planned and realised solely by one of the parties or it may also involve judges who are corrupt or lack independence (in some countries the latter is a recurring factor facilitating illegitimate takeover of companies or distortions of competition).²¹⁷

Box 6. Misuse of court decisions in corporate raiding²¹⁸

“Use of court decisions (including those of the courts of arbitration) issued without reasonable grounds. Court decisions serve as the ground for practically everything – ban on convening of the general meeting, prohibition to specific shareholders to attend the general meeting, change of management, sequester of property, confirmation of the property title and the rights for shares, debts, validity of the resolutions of the general meeting etc. Court decisions also serve as the basis for hostile takeovers through the bankruptcy proceedings and liquidation of the company. Even if the above decisions are cancelled in the future the raiders manage to strengthen their positions using other methods during the procedure of appealing. The essential role of courts in implementation of raider schemes is confirmed by the facts that recently there have been passed several bills related to establishment of the conditions for impossibility of participation of courts of arbitration in raider schemes and establishment of criminal prosecution against the judges who take the decisions exceeding the sphere of their competence.”

Courts can be misused, for example, to obtain court decisions, which legalize counterfeited documents, arrest shares of the majority shareholder or other assets, or prohibit sales of company property (including products to customers). In other instances interlocutory injunctions paralyze the exercise of voting rights in shareholders’ meetings.²¹⁹ In the most clear-cut cases of corruption judges make deliberately illegal decisions.²²⁰ Even when it has proved possible to reverse an interlocutory injunction, its negative consequences have often already taken place and are not reversible, especially when an injunction has affected the voting rights of the targeted shareholder-defendant. At the same time, proving the corruption of a judge who has arbitrarily adopted an injunction facilitating a corporate raid is almost impossible.

²¹⁷ See, for example, Zimmerer, G. (2012) *Raider Attacks in Ukraine*, p.4, available at <http://ti-ukraine.org/>

²¹⁸ Shmagina, Y, Patsyuk, V, *Raider appears out of nowhere, there’s no way to escape*, ULGroup Association, available at <http://ulga.com.ua/>

²¹⁹ Journal "Law and investment" (2009), *Proposals to improve the efficiency of the fight against raiding (illegal seizure of property)* [Предложения по повышению эффективности борьбы с рейдерством (незаконным захватом собственности) Журнал „Недвижимость и инвестиции. Правовое регулирование”] Nr 1 (38), available at <http://dpr.ru/>

²²⁰ A. Fedorov (2010), *Raiding and corporate blackmail*, [Рейдерство и корпоративный шантаж], pp. 44, 47, 96, available at www.zahvat.ru/

The possibility to demand and obtain an interlocutory injunction on a potential defendant's assets in civil proceedings is a procedure of particular risk. This procedure can be abused either because standards for the satisfaction of such request are too vague or liberal or, in the worst cases, the judge is not fair and independent. In a corporate conflict an unscrupulous party may find an interlocutory injunction particularly useful because it may cause immediate major damage to the opponent (e.g. business operations may halt immediately after an important asset is frozen), the review of such claim against a defendant may be possible without participation of its representative²²¹, and the standard of proof for the claim at this stage may not exceed the existence of a *prima facie* case.

4.2.1 The Russian Federation

In accordance with Article 99 of the Code of Arbitration Procedure of the Russian Federation, the Arbitration Court, upon application of organisation or citizen, is entitled to take interim protective measures to ensure the property interests of the applicant before bringing of an action. The Federal Arbitration Court (FAS) of the Ural region, in its decree of April 29, 2009 N F09-2512/09-C6, cited this right and explained that interim measures may be taken by the court, if the absence of these measures may make it difficult or impossible to execute a judicial act, as well as in order to prevent causing significant harm to the applicant.

Interim measures must meet the stated requirements, i.e. be directly related to the subject matter of the dispute, proportionate to the declared requirements, necessary and sufficient to ensure the fulfilment of a judicial act or prevent injury. However, unscrupulous participants in civil relations can use interim measures to solve their own problems rather than protect subjective rights. Not always the ban or restriction of the right to use or dispose of the seized property is justified. For example, in its appellate decision dated 4 July 2012, the Volgograd Regional Court in the case N 33-5887/12 met a request to invalidate a ruling of a court bailiff on seizure since there was no evidence of a need to ban the use of frozen assets of the debtor.

4.2.2 International standards

The power given to courts to issue injunctions in order to make illegal practices cease is, by all accounts a fundamental right of any legally established sovereign State. The main purpose of injunctive relief is to ensure that illegal practices cease as soon as possible. Oftentimes, the inability to obtain an interlocutory injunction will make the subsequent judicial proceedings useless, as irreparable damage will have been caused by the time a final judicial decision is adopted on the merits.

The possibility to adopt injunctive relief is foreseen by several international instruments: Article 50 of **the Agreement on Trade-Related Aspects of Intellectual Property Rights**²²² (TRIPS) states that member States must ensure that their national courts are empowered to take the provisional measures when appropriate without having to hear the defendant, in particular when any delay would cause irreparable harm to the right holder.

4.2.3 Other international standards and the Council of Europe member states

At the European level, interlocutory injunctions have been introduced and regulated in specific fields such as the protection of intellectual property, consumer rights and competition law.

The Injunctions Directive 98/27/EC ensures the defence of the collective interests of consumers in the internal market by providing means to bring action for the cessation of infringements of consumer

²²¹ The review of matters without participation of the defendant may be a dangerous method to threaten the defendant also in other situations, e.g. by establishing debts that may be even unknown to the target. See, for example: Zimmerer, G. (2012) *Raider Attacks in Ukraine*, p.6. Ibid.

²²² World Trade Organisation, *Agreement on Trade-Related Aspects of Intellectual Property Rights*, available at www.wto.org/

rights. At the European Union level, injunctions can also be adopted in the context of competition law.

The European Union Directive 2004/48/EC on the enforcement of intellectual property (IPRED), for example, requires EU member States to make certain measures available to rights-holders, including the ability to apply for an injunction intended to prevent an imminent infringement, or to forbid the continuation of the alleged infringement. The directive further specified that such injunctions should be fair and equitable and shall not be unnecessarily complicated or costly, nor entail unreasonable time limits or unwarranted delay. They must also be effective, proportionate and dissuasive and should be applied in such a manner as to avoid the creation of barriers to legitimate trade and to allow safeguards against their abuse. The directive, similarly to Article 50(2) of the TRIPS recommends for example that, in case injunctions have been adopted without hearing the defendant, the national law should ensure a review hearing to be held, to safeguard the rights of defence of the defendant.

Almost all European countries also afford special remedies to secure evidence by seizing specific documents which are of relevance to the proceedings or ex parte search orders which may be granted in cases of trade secret or IP violation and aim at obtaining a description of the allegedly infringing information or good. It should be noted however that these provisions encounter severe limitations in the legislation protecting access to data and other personal information. Besides this protection of intellectual property, trade secrets and other confidential information entail that specific procedures are introduced to avoid fishing expeditions and other infringements of confidential information: oftentimes only courts or applicant's lawyers are granted the right to get acquainted with the obtained information. In practice such specific orders are almost never granted given the too high risks for violation of other rights: extremely high burdens of proof are laid on the applicants in order to grant their requests.

Proceedings in the absence of the defendant

In all European Union member States, a provisional or precautionary measure can be issued without the defendant having been heard. This is mainly in cases when it is unlikely that the rights holders will be able to recover damages, or where there is a risk that evidence will be destroyed, or that the proceedings will be delayed by hearing the defendant, thus causing irreparable harm to the rights holder, when the prior service of the application for an interim measure would be likely to hinder the effective enforcement of the precautionary measure or seizure, or when possible counter arguments by the defendant would be invalid.

In Portugal the courts will unlikely grant injunctions without the defendant having been heard. In Austria interlocutory injunctions can be granted without hearing first the defendant if the claimant will be unlikely to recover damages should the alleged infringer be informed. In Belgium such injunctions require a higher standard of evidence such as an absolute necessity as without the injunction the rights of the applicant will be seriously and irremediably harmed. In Germany an applicant for such an injunction will have to provide prima facie evidence that the possible counter arguments of the alleged infringer are not valid²²³.

Standard of evidence

Level of evidence required to satisfy the court that the applicant is the rights holder and that his rights are being infringed or that the infringement is imminent varies among countries although the minimum standards is usually the existence of a prima facie case.

In the UK pursuant to the copyright, design and patents act 1988 an applicant is required to prove, on a balance of probabilities, that he is the intellectual right owner and the act has introduced certain

²²³ European Commission, *Injunctions in Intellectual property rights*, European Observatory on counterfeiting and piracy, available at: <http://ec.europa.eu/>

presumptions of copyright ownership, while in relation to trademark and patent rights, the fact of registration is taken to be evidence that the applicant is the owner of the industrial property right.²²⁴

The claimant is usually required to prove that it will be unlikely to recover damages unless the injunction is granted, however in the UK the applicant is required to prove that it will not be able to be adequately compensated by damages following ordinary proceedings. In certain countries, once a cease and desist order sent to the infringer has been ignored; the court may consider this circumstance as evidence that the threat is serious and the violation is imminent. In Finland the Supreme Court has required that the courts make a proportionality analysis by comparing the benefits to the applicant from the granting of the injunction with the costs and prejudice to the alleged infringer. In Belgium courts usually apply an absolute necessity test to grant injunctive relief.

In Germany the obviousness of the infringement has an impact on the level of difficulty of the procedure: in case an injunction seeks to secure claims for damages stemming from a violation, a detailed specification on the determination of the amount of damages is required. The value of the claim is usually established by the court and is between 1/3 and 1/2 of the damages²²⁵.

Defendant's rights

In countries such as, Poland, Spain, Portugal and Sweden interim injunctions must be confirmed through ordinary proceedings on the merits to become final and failure to start the ordinary proceedings makes the injunctions void and unenforceable²²⁶.

Pursuant to the IPRED, member States have also introduced provisions ensuring that provisional measures are revoked or otherwise cease to have effect upon request of the defendant, if the applicant does not institute, within a reasonable period, proceedings leading to a decision on the merits of the case before the competent judicial authority. The determination of the reasonable period is either made by the competent court or is established by law (usually 20 or 30 working days).

Usually, in order to grant an interim injunction, the court must require the applicant to provide reasonably available evidence to satisfy the court with a certain degree of certainty that the applicant is the rights holder and that his rights are being infringed.

Pursuant to Article 584 of the Judicial Code of Belgium, if the measures are revoked or are no longer applicable due to an act or omission by the applicant or due to it being found that no infringement or threat of infringement has occurred, the court may order the applicant to pay the defendant appropriate compensation for any injury caused by the measures. This compensation is however conditional upon the request of the defendant.

In Finland such compensation is granted irrespective of whether the costs have been caused due to negligence or intent by the applicant while in France the defendant can ask for compensation based on Article 1382 for abuse of procedure²²⁷.

In Spain compensation is granted to the defendant against whom an injunction has been granted without hearing and who has suffered damages as a result of the measure²²⁸.

In United Kingdom the applicant will usually be required to provide a cross undertaking as to damages, which is a promise to make good any losses suffered by the defendant in connection with the execution of the injunction if it becomes apparent that the applicant was mistaken. A defendant will be able to ask that a cash payment as security instead of a ban guarantee be provided if he has bona fide concerns over the applicant's solvency or if the applicant is from overseas. The applicant

²²⁴ *Copyright, Designs and Patents Act 1988* is available at www.legislation.gov.uk/

²²⁵ Florian Wolff; Dietmar Voelker; Kristofer Bott Published (2005), *German Tax and Business law*, Sweet & Maxwell

²²⁶ Above at 220

²²⁷ Ibid

²²⁸ Ibid.

will be liable to pay compensation if it is discovered that he did not make full and frank disclosure of all material facts including facts that an injunction should not be granted

Finally in certain countries injunctions will be admissible also against third parties who have received property from the alleged infringer. Oftentimes such remedies are available irrespective of the third party's good or bad faith although third parties will not be held liable for damages unless they had been negligent or had knowledge of the misappropriation. In Italy, specific provisions concerning trade secrets will enable an applicant to launch proceedings for misappropriation and unfair competition against third parties if the recipient is aware of the misappropriation²²⁹.

Security deposit and other requirements imposed on the applicant

Courts may also subject the adoption of an interim injunction to the payment by the applicant of an adequate security deposit or a guarantee, intended to ensure that compensation is available if required, for any prejudice suffered by the defendant.

In Sweden an applicant usually is required to lodge security to obtain a provisional measure. The amount of the security is made on the basis of a discretionary assessment by the court on the basis of circumstances such as the scope of the infringement, the plausibility of the infringement and the damage that may be caused to the defendant. While in Italy a security is not required, in Spain courts will always subject the issuing of an injunction to the payment of a security.

In Belgium, pursuant to Article 584 of the Judicial Code the court can order the applicant to lodge adequate security or an equivalent assurance in order to compensate any possible damage suffered by the defendant. The amount is determined on the basis of the likely prejudice that the alleged infringer may suffer as well as the other circumstances of the case.

In UK the granting of an injunction tends to be costly and procedurally complicated while in Italy injunctions and other emergency measures in the field of IP and trade secrets protection are granted within few days.

It is also possible that, if the provisional measures are revoked or where they lapse due to an act or omission of the rights holder, or where it is subsequently found that there has been no infringement or threat of infringement of a right, the court shall have the authority to order the rights holder, on request by the defendant, to pay the defendant appropriate compensation for any injury caused by those measures.

In Italy, however, the Industrial Property Code has introduced a provision whereby once an interim injunction is granted, may become final if both parties refrain from filing proceedings on the merits as the injunction is treated as an anticipation of what the outcome of the proceedings on the merits would be. The court can also order the applicant to pay the defendant appropriate compensation for any injury caused by the injunction.

In Denmark, the court sets the amount of the deposit and gives a few weeks for the applicant to post it.

Fines for failing to comply with the injunction

Sanctions for failing to comply with injunctions vary widely among countries. In certain countries, while it is possible to obtain the imposition of a fine, such fine tend to be low and the remedy is usually in the form of a claim for damages at a later stage. In Austria, however, if a defendant violates the injunction, the applicant can apply to the court for the imposition of a penalty of up to 100,000 euro. In certain countries provisions have been introduced to allow recurring penalty payment following a hearing where both the applicant and the alleged infringer will be heard.

²²⁹ Ibid

Criminal Liability

In certain countries the intentional failure to comply with an injunction is criminally sanctioned. In the UK fines and ultimately imprisonment can be imposed as failure to obey court orders are considered in contempt of court.

In Germany it is possible to impose fines of up to € 250,000 or six months imprisonment, while in Italy deprivation of liberty can extend up to three years.

4.2.4 Conclusions

Granting of the interlocutory injunction can be abused either because standards for the satisfaction of such request are too vague or liberal or, in the worst cases, the judge is not fair and independent. In a corporate conflict, an unscrupulous party may find an interlocutory injunction particularly useful because it may cause immediate major damage to the opponent (e.g. business operations may halt immediately after an important asset is frozen), the review of such claim against a defendant may be possible without participation of its representative, and the standard of proof for the claim at this stage may not exceed the existence of a *prima facie* case. Such problems are known in both the Russian Federation and other countries.

Like in other countries, in the Russian Federation, the court is entitled to take interim protective measures to ensure the property interests of the applicant before bringing of an action. According to the Russian legislation interim measures must meet the stated requirements, i.e. be directly related to the subject matter of the dispute, proportionate to the declared requirements, necessary and sufficient to ensure the fulfilment of a judicial act or prevent injury. However, unscrupulous participants in civil relations happen to use interim measures with malicious intent where the issue is not protection of legitimate subjective rights. There is case law testifying that not always the ban or restriction of the right to use or dispose of the property is justified.

All European countries have some safeguards against such misuse, for example, higher standards of evidence where injunctions are granted in the absence of the defendant, requirements for the court to assess the proportionality between the benefits of the applicant and the costs and prejudice to the defendant, compensation for damage to the defendant, the requirement of a security deposit from the claimant, etc.

4.3 Preclusive effect of judicial decisions in civil and commercial cases

In specific situations a party to a corporate conflict may suffer when it is affected by a court decision in a civil case and it was itself not a participant or represented in the proceedings. Legal relationships may be established or abolished without provision of an opportunity to the concerned third party to challenge evidence, claims or the final decision.

4.3.1 The Russian Federation

In 2009 amendments to the Code of Criminal Procedure were introduced, following the decision of the Constitutional Court in the Surinov case, whereby the court quashed the conviction of the applicant as he had been unable to get the charges of embezzlement against him dismissed notwithstanding that he had obtained rulings by the “*arbitrazh*” courts stating that he had acquired the disputed property legally. In accordance with the amendments the findings of “*arbitrazh*” courts were made binding on investigators and prosecutors. Although the decision in the Surinov case has been considered as well motivated²³⁰, such amendments have been considered as opening risks to abuses of the “*arbitrazh*” procedures by bad faith litigators.

One such example of the abuse of preclusive effects of judicial decisions involved a Norwegian company. In the Telenor case, after a dispute arose between the Norwegian company Telenor and its joint venture partner Storm in connection with Kyivstar (a mobile telecoms joint venture), Telenor brought arbitral proceedings against Storm in 2006 pursuant to the arbitration agreement in their Shareholders Agreement. What followed was a series of proceedings in multiple jurisdictions. After Telenor initiated arbitration, Storm’s parent company began collusive litigation against Storm in Ukrainian court seeking to invalidate the Shareholders Agreement. Storm did not retain counsel or oppose the Ukrainian action and Telenor was not named as a defendant. On appeal, the appellate court held that the arbitration clause in the Shareholders Agreement was invalid.²³¹ In this way, through collusive litigation and the abuse of preclusive effects of judicial decisions, Storm managed to obtain the invalidation of the agreement with Telenor.

4.3.2 Council of Europe member states

European countries have adopted a detailed regulation of preclusive effects of judicial decisions in civil and commercial cases. Such regulations cover among the others the effects of judicial decisions towards third parties.

France

In France, a judgment will be considered irrevocable and therefore capable of having preclusive effects if the party against whom the judgment is enforceable receives notification of the execution, and the judgment is not subject to any review staying its execution.

A judgment will have claim preclusive effect in respect of another claim if the second action involves (1) the same parties; (2) the same relief; and (3) the same legal grounds.

A judgment’s claim preclusive effects apply to all the parties in the action, as well as those parties who have intervened, and those third parties who have been brought into the action usually for purposes of indemnification.

A judgment, as a rule may not have an effect on a third party although some judgments have *erga omnes* effects in the sense that they must be taken into account by third parties. This occurs typically in relation to judgments in nationality, intellectual property and filiation litigation.

²³⁰ PA Skoblikov (2009), *The World of Law*, N 2, “acts of arbitration courts in criminal proceedings: a new reading” [*Журнал российского права, Преюдиция актов арбитражных судов в уголовном процессе: новое прочтение*] System GARANT, available at <http://base.garant.ru/>

²³¹ Gary Born, Wilmer Cutler Pickering Hale and Dorr LLP (2009), *Telenor Mobile Communications AS v. Storm LLC*, Kluwer Arbitration Blog, available at <http://kluwerarbitrationblog.com/>

If third party has an interest in the litigation and he/she was neither a party nor represented in the first action, he/she is allowed to challenge the decision by appealing a court to set it aside.

Germany

Most judgments are capable of having substantive *res judicata* effect per §322 of the Code of Civil Procedure (ZPO). The scope of *res judicata* is, though, narrow and does not cover preliminary matters or the judgment's reasoning. A judgment may have preclusive effect if it has the "same cause of action" (§322(1) ZPO) and "same parties" of another claim.

Claim preclusive effects will not cover findings of fact, even if these are contained in the reasoning of the judgment and the judgment is based upon them; nor are findings of law or defences raised by the defendant covered. These can thus be relitigated in future claims.

A party can however seek an additional declaratory judgment to create *res judicata* over matters which were only incidentally relevant for the decision in the main action (e.g. in an action for contractual damages, the defendant may seek not only a dismissal of the action for damages, but also a declaratory finding that the contract is invalid, thereby extending *res judicata* to the question of validity of the contract, § 256 (2) ZPO).

Preclusive effects extend only to the parties, their legal successors (§325(1) ZPO) and co-claimants/defendants (§322(1) ZPO).

However a party can file a claim for extension called *Interventionswirkung* (§§74(3), 68 ZPO), the effect of which is precluding the third party from questioning the factual or legal basis of the first decision. It does not however extend to factual or legal findings unnecessary to the earlier decision.

Although incidental findings of law or fact are not binding for later proceedings, if an element which was indeed part of the procedural claim (*Streitgegenstand*) of an earlier action comes up as an incidental question in later proceedings (e.g. an earlier declaratory judgment ruled on the ownership of certain property, the issue of ownership comes then up in later proceedings for damages concerning that property), the court in the later action is bound as far as the incidental question is concerned

Romania

In Romania the preclusive effect of a judgment applies to claims that have substantially the same object, that are based on the same cause of action, have the same legal basis, and involve the same parties as in the original litigation.

Preclusive effects also extend to co-claimants/defendants and third parties and interveners in the original proceedings. For this purpose, courts can order multiple co-claimants/defendants to be represented at trial. Successors, co-debtors and spouses (where the judgment relates to common property acquired during marriage) will be bound by judgments even if they were not parties to the proceedings as there is a substantial connection between the non-party and a party to proceedings.

Claim preclusive effects do not extend to persons not connected in a legally relevant way to the parties in the proceedings.

Sweden

Claim preclusive effects apply to claims that concern the same 'matter at issue' as the first. The term 'matter at issue' has been interpreted by the Swedish Supreme Court generally to focus on the remedy requested which means that the judgment will have preclusive effect in relation to all circumstances which can be alleged as support for the same remedies, regardless of whether they have actually been alleged. This preclusion also applies to quantitative changes in a claim with respect to the amount of damages requested. The Supreme Court has interpreted legal force to include the same remedy and remedies which are alternative and financially equivalent to the remedy in the first action. Cumulative remedies, by contrast, do not preclude a subsequent action based on the same set of circumstances.

A party to a claim that has been decided with a decision entered into legal force may not commence new litigation based on the same claim that would deprive the previous judgment of its effect. If a new action was brought on the same claim against the same party while the first action is still pending, the court must dismiss the case based on *lis pendens*; however, the court has the option to stay the second action pending the first judgment.

Legal force also binds third parties who are connected in a legally relevant way to the claimant or defendant. For example, when a party transfers his rights to property to a third party, during litigation, the judgment will have legal force against the third party. Partners in a partnership are jointly and severally liable for the obligations of the partnership and so will be bound by a judgment rendered against the partnership. A judgment in a payment case between a debtor and creditor applies to the advantage, but not to the detriment, of the guarantor/third party. Finally, in company law, a shareholder generally has no liability for the obligations of the company; however, general liability may be imposed on certain shareholders based on whether the corporate veil has been pierced.

Judgments may have *erga omnes* effects in situations involving declarations of patent invalidity whereby such a judgment has universal legal force. This type of legal force is unilateral in the sense that if the claim is denied, other parties are not prevented from seeking such a declaration²³².

Spain

Pursuant to Article 222 of the Code of Administrative Proceedings (CPA) a final judgment upholding or rejecting a claim will have substantive *res judicata* effects preventing later proceedings with an identical subject matter between the same parties.

Only final judgments deciding a claim on the merits are capable of substantive *res judicata* effect, preventing subsequent proceedings with identical subject-matter and parties. For this reason *res judicata* does not apply to settlements between the parties which are merely recorded by a Court order or where proceedings are withdrawn as in such instances the court has not ruled on the merits.

Article 222 of the CPA only explicitly requires identity of subject matter before preclusive effects are engaged. However, it is clear from both legal commentary and case law that the triple identity test of same parties, cause of action and subject matter are in fact needed before claim preclusion will operate.

The Supreme Court has provided guidance as to the definition of “same cause of action”, stressing that the Court should compare the essential facts or title which underlie the basis of the claim to determine if the same cause of action is in issue. As such many commentators limit the scope of *res judicata* to the operative part of the judgment and not to defences raised, legal considerations or proven facts. The Supreme Court has made clear that the binding effect of the earlier decision extends not only to the operative part of the judgment but also to those elements of the decision which condition the ruling and which are logically necessary for the determination of the claim.

Judgments on solely procedural issues will generally not have substantive *res judicata* effects, though those decisions which end proceedings due to a lack of a procedural requirement are thought to have *res judicata* effects limited to the procedural questions forming the subject matter of the decision (e.g. a ruling as to jurisdiction).

Res judicata extends to co-claimants/defendants and third parties who intervened upon court orders, while parties who intervened *sua sponte* are not touched by *res judicata* as they are considered as only having an indirect interest in the dispute.

²³² Andrew Dickinson (2007), *The Effect in the European Community of Judgments in Civil and Commercial Matters: Recognition, Res Judicata and Abuse of Process*, available www.biiicl.org/

Article 222 para. 3 of the CPA explicitly extends the *res judicata* effects of judgments to the heirs and assignees of the parties and also to all shareholders entitled to bring an action of challenge of corporate resolutions irrespective of whether or not they have challenged the resolution.

In cases of indivisible obligations or co-ownership claims, mandatory rules entail the joinder of the claimants/defendants so they will be considered parties to proceedings to which *res judicata* applies. Companies within the same corporate group will not, generally, be bound by a judgment affecting one company within that group, since all the companies are distinct legal persons. However, in some circumstances, generally where fraud is involved, the Court may pierce the “corporate veil” and look beyond the form of the parties to their substantive identity.

Judgment ruling on marital status, marriage, affiliation, paternity, incapacity and reinstatement of capacity are also given an *erga omnes* effect.

4.3.3 Conclusions

The regulation of preclusive effects of judicial decisions is a common feature of codes of civil and administrative procedures. Such provisions are aimed at coordinating to some extent, judicial decisions, and at ensuring the unity of the judicial system. They also respond to considerations of judicial efficiency avoiding re-discussing evidence that has already been reviewed in court.

However preclusive effects may be abused by bad faith litigants who seek to obtain predetermined judicial decisions which can then be imported into other proceedings affecting the right and interests of third parties.

The countries reviewed in the comparative analysis have introduced a plurality of safeguards which limit the preclusive effects of judicial decisions to protect third parties’ rights and interests. Such effects for example usually apply only to the same parties to the original proceedings, the same relief and the same legal grounds. Claim preclusive effects may not cover finding of facts or legal findings not necessary to the earlier decision hence excluding issues that have been decided incidentally by a court (Germany). The preclusion may not apply to third parties with the notable exception of judgements which may have *erga omnes* effects such as judgements in nationality, intellectual property and filiation litigation (France). In order to secure that judgements have effects in respect of co-claimants or co-defendants, courts may be empowered to order that they be represented at trial (Romania). A judgement between a debtor and creditor may apply to the advantage but not to the disadvantage of the guarantor or third parties (Sweden).

These regulations witness the need to ensure effective protection of third parties’ fair trial rights. Such guarantees have been increasingly considered as outweighing other considerations and standards such as the unity of the judicial system.

4.4 Limits to the protection of good faith purchasers

Illicit actions in corporate conflicts and takeovers often involve fraudulent transfer of assets, property rights or other entitlements. The execution of a corporate raid typically involves three stages: creating or corruptly obtaining a legal document establishing faux legal title to some assets (usually shares or real property belonging to the business); the carrying out of a forcible takeover of the target company; and the laundering of seized property through a series of shell companies to an ostensible good faith purchaser. Shell companies typically disappear as soon as they have fulfilled their purpose and the victim is left with no one to pursue.²³³ The damage caused may be irreversible even after the fraudulent act has been proved in law and it may be impossible to restore the previous situation when the asset or right has been acquired by a third party as a good faith purchaser. The practical

²³³ Thomas Firestone, *Armed Injustice in Denv J. Int’l L & Pub Pol’y* Vol 38:4.

impossibility of clawing back laundered assets following a corporate takeover has been admitted by official sources.²³⁴

Such raiding schemes are made possible by the interplay between the regulation and judicial practice limiting recovery of assets against good faith purchasers and the misuse of shell companies (off shore companies as well as “one day” companies – *odnodnevki*).

Box 7. Raiding scheme involving misuse of protection for good faith purchasers²³⁵

“For the capture of objects with large, consolidated stakes, shares are not bought, rather assets are stolen. In order to do this, [raiders] change information about the director by submitting to a tax body a false protocol of electing a new director general.

[He/she] signs a sale-purchase contract with an intermediary company, which sells the property further. In such way, the end-owner obtains the status of a good faith purchaser, which protects against claims of the previous owner. Afterwards the legal entity whose property was so removed is merged with an ephemeral company and then the liquidation follows. Afterwards also the company, through which the property was transferred, is also liquidated. It is very time consuming and expensive to challenge such scheme in the court.”

4.4.1 The Russian Federation

Article 167 of the Russian Civil Code states that when a transaction is declared invalid each party to the transaction must return to the other(s) everything that it has received in the deal and make appropriate monetary compensation. Russia’s Constitutional Court has, however, held that these provisions cannot be extended to a good faith purchaser unless specifically provided for by statute.

The head of the Investigative Committee has supported the adoption of measures to make it easier for raiding victims to recover property even from legitimate good faith purchasers.

In 2012 an Inter-Agency working group for the fight against unlawful financial operations was established to combat money laundering and the abuse of shell companies. Measures undertaken to this end include:

- Enhancing corporate transparency by introducing beneficial ownership requirements in the Anti-Money Laundering legislation;
- Prohibiting credit institutions from opening and maintaining anonymous accounts, or accounts in fictitious names, and amending the AML/CFT Law applicable to due diligence exceptions; and
- Amending legislation to prevent criminals from becoming major shareholders in financial institutions and introducing 'fit and proper' requirements for actors in the financial sector.

At the time of writing the effectiveness of these measures is yet to be assessed.

Box 8. Raiding Scheme of misappropriation of real estate

In December 2013 a raiding scheme involving the misappropriation of real estate in the centre of Moscow was uncovered by the Investigative department of the Ministry of Interior. The raiders, with the collaboration of employees of the State registry, had forged legal documents to establish ownership over real estate for a total value of more than one billion roubles. The property was then re-registered several times through a set of shell companies in order to ensure that the good faith purchaser exemption would apply. The material apprehension of the property would then take place

²³⁴ Ibid, Notes 71 and 72.

²³⁵ *Direct capture of business* [Прямой захват бизнеса] available at www.regy.ru/

with the help of contracted armed individuals. The attempts of the legitimate owners to recover the property through the courts had proven fruitless.²³⁶

4.4.2 International Standards

The fight against the misappropriation and laundering of assets has, in recent years, been waged by a concerted international effort. The Financial Action Task Force (FATF), an inter-governmental body established in 1989 has set standards and promoted effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

In 2006 the FATF published a report²³⁷ on the misuse of corporate entities, including trust and company service providers for illicit purposes. The report has identified vulnerability for money laundering, and evidence of general misuse, for such entities. The most significant feature is the hiding of the true beneficial owner. The report has identified a number of frequently occurring risk factors associated with corporate entity misuse which could be useful to countries in helping identify such wrongdoing.

In its report *Behind the corporate veil*²³⁸ the OECD noted that almost every economic crime involves the misuse of corporate entities for illicit purposes, such as money laundering, bribery and corruption, shielding assets from creditors, illicit tax practices, market fraud, etc. The report seeks to develop mechanisms to reduce the vulnerability of corporate entities to misuse for illicit purposes (e.g. by obtaining and sharing information on beneficial ownership and control).

4.4.3 Council of Europe member states

Roman law's basic principle that no one can transfer a better title than he himself has (*nemo plus iuris transferre potest quam ipse habet*) is limited in civil law countries by several rules that enable *bona fide* purchasers to acquire ownership from an apparent owner. Such rules represent a compromise between the protection of ownership and the security of transactions.

In contrast, the common law doctrine of estoppel requires additional circumstances, or *indicia*, of ownership to confirm this assumption.

Italy

Pursuant to Article 1445 of the Italian Civil Code an invalid contract shall be opposable to third parties if the invalidity depended on legal incapacity, irrespective of whether the third party was in bad faith or not. Invalidity of a contract that does not depend on legal incapacity shall not affect the rights acquired upon payment by third parties in good faith. In the Italian jurisprudence good faith has been interpreted as subjective ignorance on the part of the third party that he was violating someone else's right.

Good faith is understood, in psychological terms, as the belief in, or excusable ignorance of, the ownership of the rights transferred. A good faith acquisition is ruled out if the transferee knows, or, in the absence of gross negligence, should have known, that the transferor did not have the right to transfer the rights transferred. The burden of proof is on the legitimate owner. According to settled case law (concerning the *bona fide* acquisition of movables) a lack of knowledge is attributable to gross negligence if the acquirer disregards circumstances that anybody else would have realized.

²³⁶ Alla Proskurina (2013), *Raiders attacked the elite real estate in Moscow* [Рейдеры атакуют элитную недвижимость Москвы] available at <http://igolkin.blogspot.ru/>

²³⁷FATF, *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers*, available at www.fatf-gafi.org/

²³⁸ OECD (2001), *Behind the Corporate Veil*, available at www.oecd.org/

The Italian Civil Code states that it is sufficient that the purchaser was acting in good faith at the time of the transfer of the rights, but these *bona fide* rules normally require an objective basis on which the acquiring party may rely.

Ordinarily this is found through registration in state registers, and in the possession of movable property, or securities, which indicates that the transferee's assumption of the transferor's title is correct. The protection of good faith is, however, substantially limited by the existence of a detailed regime regulating the transfer of real estates and of securities.

Other provisions address specific hypotheses such as civil remedies against creditor fraud. In such cases, creditors are (pursuant to Article 1167 of the Civil Code) allowed to obtain the revocation of such deals when they have been fraudulently committed.

The right to obtain a revocation will cover only certain acts such as donation. In such cases the courts will not even require proof of the bad faith of the debtor as the transfer of property for free is sufficient to give the creditor a right to obtain the revocation of the donation.

The courts have authorised creditors to directly pursue (or "claw back") from third parties the assets fraudulently conveyed, as requiring third parties to return the property in the hands of the debtor would be in violation of the purpose of revocation action.

To exercise the claw back right of action it is not necessary that the debtor be insolvent; it is sufficient that the deal has caused danger or uncertainty for the realization of the right of the creditor.

The risk may consist not only of a quantitative modification of the debtor's assets, but also a qualitative change, when that change is such as to make it harder for the satisfaction of the creditors themselves.

The second precondition for a claw back action is that the third party was aware of the injury or that the third party was a participant in the fraudulent intention (*participatio fraudis*).

On this point, it is appropriate to distinguish between the treatment of the above condition depending on whether it is:

- prior to the granting of credit: in this case, the creditor has the burden of proving that the debtor, at the date of its conclusion, was willing to go into debt (or at least was aware that in the future the obligation might arise) and performed the act with the purpose of frustrating the future obligation towards the claimant, in order to preclude or make it more difficult to implement execution action by the creditor; or
- after the granting of credit: in this case, the awareness of the damaging event by the third party contractor, is the general knowledge of the prejudice that the act may cause to the creditors. Collusion between the third party and the debtor is not required.

It is a misdemeanour for third parties to negligently acquire "suspicious" goods or credit. This offence is distinct from the receipt of stolen goods or money laundering and targets those who fail to exercise due diligence when they ought to have suspected the illegality of their origin.

Pursuant to Article 712 of the Criminal Code ("incautious purchase") anyone who, without having first ascertained their legitimate origin, buys or receives for any reason things that, from their quality or the condition of the person who offers or the extent of the price, there is reason to suspect that they come from crime is guilty of incautious purchase.

This subjective element of failing to exercise due diligence differentiates incautious purchase from the crime of receiving stolen goods (which requires intention) The punishment for such a misdemeanour is imprisonment for up to 6 months or a fine of not less than EUR 10.

France: Action Paulienne and insolvency proceedings

The protection of third parties is limited by the “Paulian action” which allows claims to be made against third parties to whom the insolvent debtor had transferred assets to conceal or to otherwise frustrate his creditor. In a Paulian action, the defrauded creditor seeks to leapfrog over the fraudulent transaction and seeks to have the transaction reversed by the court.

Pursuant to Article 1167 of the Civil Code, creditors can, on their own behalf, attack fraudulent transactions made by their debtors.

In order to successfully challenge these transactions the claimant must prove both the existence of the fraud; and that the debtor was aware of the damage it did to his creditor. There is no requirement to prove malice on the part of the debtor, but the creditor must prove insolvency.²³⁹

Proof is also required that the third party was complicit in the fraud, although in transfers without payment the good faith of the recipient is irrelevant.

In a judgment of 5 July 2005, the Court of Cassation²⁴⁰ stated that the debtor could challenge the claw back action by proving that he had assets of sufficient value to meet his commitment to the creditor.

The French Commercial Code has introduced a specific form of Paulian action to challenge antecedent transactions in insolvency proceedings.

Certain transactions entered into, or payments made, between the actual date of insolvency (as fixed by the court) and the judgment opening insolvency proceedings (the “Hardening Period”) may be declared null and void. For transactions made for no consideration, the 18 months period is extended for an additional six months.

Certain transactions entered into, or payments made, during the Hardening Period are automatically voidable by their nature, in particular:

- Transactions made without consideration; “unbalanced” transactions (i.e. those in which the obligations of the debtor are notably in excess of those of the other party); prepayment; payment made otherwise than in a manner commonly accepted in business transactions; deposit, or escrow of money without a final court decision;
- security in relation to pre-existing debt; attachment or other remedial measure in favour of a creditor; and the authorisation, exercise or resale of “stock options”.

The court may nullify any payment or agreement entered into or made during the Hardening Period if those dealing with the debtor were aware of his insolvency.

The court can extend the Insolvency Proceedings of one entity to another entity (either a legal or natural person, belonging, for example, to the same group as the insolvent entity) if either: the assets and liabilities of these entities are commingled (*confusion des patrimoines*); or the legal personality of the company is fictitious (*société fictive*). As a result of the extension, the two entities will become subject to the same insolvency proceedings.

²³⁹ Court of Cassation, Bull 173.

²⁴⁰ BICC No. 628 of 1 November 2005, No. 2009

Spain

Protection of creditors in insolvency proceedings

Amendments to the Insolvency law (SLI) 22/2003 allow claw back actions against transactions against purchasers during a period preceding the liquidation.

Under the Insolvency Law there are no prior transactions that automatically become void as a result of the initiation of insolvency proceedings. The court receivers may challenge those transactions that could be considered as having been detrimental to the debtor's interests, provided they have taken place within the period of two years from the declaration of insolvency (transactions taking place less than two years before insolvency has been declared are not subject to challenge). Those transactions, which are described as "ordinary course of business" transactions, are not subject to challenge.

Legal presumptions of damage

Damage to the debtor's interest is deemed to exist in the case of gifts and pre-payment of obligations that are due after the declaration of insolvency (if unsecured). Damage to the debtor's interest is also deemed to exist, as a rebuttable presumption, in the case of rights *in rem* that have been created in order to protect already existing obligations.

Germany: Regulation of transfer of shares into GmbH to a good faith purchaser

The GmbH is the most common form of corporation in Germany and is widely used by both small and large businesses. Traditionally, the GmbH was designed to accommodate a small number of shareholders, which would largely remain constant over time. As a result, the shares in a GmbH may only be transferred subject to specific formalities and are not tradable on the open market. Pursuant to Section 15(3) of the Limited Liability Companies Act, the transfer of shares in a GmbH must be undertaken by way of a contract that has been formally notarized in order for the transfer to be legally effective.

A 2008 law amending Article 16 of the law on limited liability companies has regulated the transfer of shares to a good faith purchaser aimed at addressing gaps in the security of transactions of GmbH-Private limited companies. While the original law did not provide for a bona fide acquisition the amendment has introduced a balance aimed at protecting the true shareholder while also taking into account the buyer's reliance upon the transferor, considering him to be the transferor.

Pursuant to the new formulation the transferee can acquire a GmbH share or a right in a share of an apparent shareholder by way of a legal transaction, provided that the transferor is entered in the shareholder list which is deposited at the commercial register. An acquisition in good faith is not possible if the transferee knows or, due to gross negligence on his part, is unaware of the transferor's lack of power or if objections attached to the shareholder list. The attachment of an objection is subject to a temporary restraining order or the consent of the person against whom the objection is made. The objecting party does not have to substantiate an impending infringement of his right.

As a result only such shareholders who are registered in the shareholders' list are deemed to be shareholders of the respective GmbH. A copy of the shareholders' list must be filed with the competent commercial register and will be made publicly available.

The 2008 reform of the GmbH introduced the possibility of acquiring shares in a GmbH in good faith whereby the shareholders' list serves as a point of reference. In principle, a purchaser can trust that a person entered in the list actually is a shareholder in the company. This applies, however, only if the respective entry has been incorrect for at least three years without objection, and, therefore, the theoretical possibility of good faith acquisitions will not actually make due diligence procedures superfluous.

The United Kingdom: *Hypotheses of liability of third parties who have received property belonging to another*

The UK has several legal mechanisms addressing the liability of third parties who have received property belonging to another and treated it as their own as well as conditions upon which they can be deprived of that property.

At common law a stranger who has misappropriated property is strictly liable even if he can show that he was acting upon the instructions of a person who appeared to be the owner of the property in question.

Another remedy is available in cases of the violation of fiduciary duties. When a trustee is subject to fiduciary obligations to hold property for the benefit of beneficiaries and, in breach of trust, he transfers the property to a recipient who is aware that this is a breach of trust the claimant can bring an action not only against the trustee for breach of fiduciary duties but also against the third party for knowing receipt of trust property. A claimant must establish that there is an initial fiduciary responsibility; that there has been a disposal of his assets in breach of fiduciary duty; that the defendant (third party purchaser) received assets which are traceable as representing the assets of the plaintiff; and that the defendant had knowledge that the assets he received were traceable to a breach of fiduciary duty. Furthermore the receipt must be a direct consequence of the breach of that particular duty.

Such rules have been applied to directors of companies who transferred a company's property in violation of their fiduciary duty. British courts have considered as liable under these rules persons who had acquired company property from a director or other senior employee if they knew that the director had no authority to enter into the transaction.

A right of action is also allowed against those parties who have not retained the property or its retraceable value but have acted dishonestly and in furtherance of a breach of trust since they will be considered as personally liable as an accessory for dishonest assistance. This aims at targeting those schemes where a number of parties are involved in a series of lined transactions and payments are fraudulently, made to shell companies which they control rather than receiving any payments directly. Although a company is a separate legal entity the British courts allow, in such cases, the lifting of the corporate veil. So while normally receipt by a subsidiary company is not viewed as receipt by a parent company an exception is possible when a corporate structure is use as a facade to conceal true facts and there is evidence of dishonesty or want of probity.

The courts usually hold find liability if a person knew, or ought to have known, that property had been transferred in violation of a fiduciary duty. It is not required that they knew or should have known all the details of the fraudulent plan. In *Twinsectra v. Yardley*, the House of Lords further held that the plaintiff, in order to prove assistance in breach of fiduciary duties, must prove that the defendant was dishonest by the standards of the reasonable and honest person and that he was consciously dishonest, taking account of the role and calling of the defendant and the degree to which the circumstances called out for further inquiry.

The British courts have also allowed the possibility that the knowledge of a company's employees or associates can be attributed to the company itself. Consequently if a shell company is being used as a means to launder stolen money, knowledge of the theft can be attributed to the company irrespective of whether the company had knowledge of the actions and intentions of the employee involved in the fraud.

The only instance when a company may oppose a fraud exception and free itself of liability is when its own officers are defrauding it.

The Insolvency Act 1986²⁴¹ contains detailed rules regulating the security of receipts that allow courts to strike down agreements and order that assets acquired by third parties under a transaction be returned. Courts can strike down an agreement that it considers to be a sham transaction. In this case it will be necessary not only that the agreement was made for an artificial purpose but that the agreement was intended to deceive. The courts are able to look at conduct that took place after the agreement was made to determine the parties' true intentions.

The provisions of the Insolvency Act apply if a company was unable to pay its debts at the time of the transaction or became unable to pay them as a consequence of the transaction.

A transaction is classified as at undervalue where the consideration received is considerably less than the consideration supplied. The burden of proving the transaction was at undervalue will usually fall on the claimant unless the transaction was made with a connected person. A transaction may be still be viewed as one at undervalue even if the full market price is paid but the transferee has received collateral benefits.

The law does not require proof of fraudulent conduct on the part of the directors and the act has introduced a strict liability for purchasers and combats fraud in the broad sense by establishing structure and order when a company is in financial difficulty.

If there is evidence that there has been a transaction at undervalue then the purchaser will be in a weak position because the defence of good faith purchase is not available to the immediate purchaser who must show that, objectively, the selling company had reasonable grounds for selling and also that, subjectively, it had acted in good faith.

Pursuant to the Act directors who make transactions at undervalue may be personally liable for misfeasance and their responsibility will not be cumulative with the liability of third parties so they may be both be required to reimburse the company. When a transaction is made at undervalue there is no need for the plaintiff to prove intent. Transactions that put one creditor in a better position than other creditors can be challenged without the need to show that there was intention to defraud creditors. It is sufficient to show that the company was influenced by a desire to make a preference.

4.4.4 Conclusions

The laundering of seized property through a series of shell companies to an ostensible good faith purchaser is the typical conclusion of corporate raiding schemes in Russia. Even after the fraudulent act has been proved in a legal procedure it may be difficult, or even impossible, to restore the previous situation if the asset or right has been acquired by a third party as a good faith purchaser. Such violations are made possible through the misuse of shell companies and because a combination of regulation and judicial practice limits the recovery of assets against good faith purchasers.

Comparative analysis highlights that certain mechanisms can be used in order to balance the rights and interests of victims with the protection of security in transactions.

The monitoring and identification of the beneficial owners of corporate entities has been consistently indicated as the most effective measure to prevent the misuse of corporate entities for money laundering purposes. Ensuring the effectiveness of the reporting of suspicious transactions by credit institutions may halt the carrying out of embezzlement schemes.

The invalidity of a contract may be made opposable even to good faith third parties if it depended on legal incapacity (Italy). Laws have been passed to criminalise the conduct of third parties who negligently acquire suspicious goods or credit. Such provision can be effective in fighting fraudulent conveyance when it is not possible to prove receipt of stolen goods or money laundering (Italy). Countries such as Germany have passed detailed regulations concerning the transfer of shares

²⁴¹ *Insolvency Act* (1986) available at www.legislation.gov.uk

introducing the obligation to notarize each transaction and regulating instances when a purchaser of shares can be considered in good faith. In the United Kingdom the recipients of misappropriated property are considered strictly liable and cannot free themselves from liability by showing due diligence.

4.5 Misuse of insolvency proceedings

There is a variety of ways of misuse of insolvency proceedings with possible vulnerabilities in both the initiation of the proceedings and subsequent distribution of assets. Malicious acts may be committed by one or more of the involved parties, e.g. the real or false creditors, managers of the target company, judges who make decisions concerning the insolvency proceedings, insolvency practitioners.

Common types of abuse on the part of the insolvency practitioners are wrongful satisfaction of claims of particular creditors, facilitation of the withdrawal of the company's assets, the overstatement of expenditures in the bankruptcy proceedings, failure to take action against transactions of the debtor right before the bankruptcy even when they can be legally challenged, etc. A particular type of misuse occurs when public bodies, e.g. tax authorities request without adequate grounds the initiation of insolvency proceedings.

A simplified raider scheme using the insolvency process may look as follows:

1. Purchase of debts from contractors, suppliers and buyers, banks (under credit agreements), holders of bills and other overdue obligations established by the court;
2. Initiation of debt collection, especially at a time when raising the claims significantly hampers operation of the enterprise and it would not be able to meet all of the financial obligations;
3. Application to the court of arbitration to recognise the debtor bankrupt;
4. Appointment of an insolvency administrator who is controlled by the raiders;
5. Creation of a large due payable and its inclusion in the register of creditors' claims. Often several front companies incorporated in off-shore territories bring the claims or promissory demands;
6. Creation of the dominant lender capable of influencing decisions of the general assembly of creditors.

As a result of such procedures, raiders obtain full control over activities of the enterprise. They can make organisational decisions and determine the fate of the company's assets. The raiders are able to limit the power of the management bodies and consolidate them in their hands (through the controlled insolvency administrator and the dominant lender). Then the raiders either achieve a takeover or make the owner strike a deal on unfavourable terms, or withdraw assets under bankruptcy proceedings, or simply eliminate the company as a competitor.

Note that often most of the stages of the process are fully legal while the whole illicit scheme may be enabled by just a single malicious act, e.g. bribing the management of the targeted company or appointment of an insolvency practitioner who has a conflict of interest.

4.5.1 The Russian Federation

When a raider seizure uses the initiation of bankruptcy proceedings, a business may be captured with the help of anti-crisis practitioners. Moreover the forced bankruptcy, widespread in the former Soviet Union, is one of the basic tools of hostile takeovers.

Box 9. Example of corporate raiding with the help of criminal bankruptcy in the Russian Federation

An example of a criminal bankruptcy can be shown based on the criminal case, filed in 2008 by the police of Nizhny Novgorod region. In 2000, the joint-stock company "RM", being a lender to the joint-stock company "MK" located in the Nizhny Novgorod region, initiated a bankruptcy procedure. During court proceedings, "RM" went to a settlement agreement, according to which "MK"

transmitted to its creditor a significant portion of its shares. Then the LLC “A” (founded by staff of “RM”) purchased the shares from “RM”. As a next step, the company “A” was renamed as the LLC “KM” using the same words as in the brand name of the victim company “MK” and the same legal address. Then “KM”, being the holder of the principal stake in the company “MK”, appointed the board of directors who decided to sell all assets of “MK”. Not only did the transaction take place at lowered prices, instead of cash the purchaser paid a promissory note with a delay of presentation of 1.5 years and the “MK” got its former assets to rent at very high rates. As a result, the “MK” went bankrupt in 2005 and the raiders sold its property at market prices.

Current Russian legislation contains no legal definition of the terms “raider” or “raider seizure”. Neither does bankruptcy legislation enumerate the abuses of bankruptcy procedures to capture companies. However, the Russian Federation has consistently carried out preventive measures against the possibility of raiding through the bankruptcy process by making the relevant changes in legislation.

A significant step was the amendment of the Federal Law №127-FZ of October 26, 2002 (hereafter – the Law on Bankruptcy) in 2002. Before these changes, the possibility to quickly capture the company was due to the fact that the business owner was not a party to the bankruptcy case. His/her authority was fully taken over by the insolvency practitioner. The owner could not resist the capture effectively and in a timely manner. This gap in the law was resolved. The Law on Bankruptcy lists parties to a bankruptcy case and the arbitration process of a bankruptcy case including the debtor/representatives of the debtor and public agencies as foreseen in the law (Article 34 and Part 1, Article 35).

Attempts of the so-called black corporate raid may involve threats to and bribing of parties of a bankruptcy case. Possibilities to prove and disclose such illegal actions depend on the level of interest of those persons against whom illegal actions are directed.

In order to counter corporate raids, the Federal Law №190-FZ of November 12, 2012 introduced major changes. They concern a number of illegal procedures, carried out by the raiders in order to seize enterprises, including seizure during bankruptcy proceedings. Criminal liability is stipulated for:

- falsification of the unified State Register of legal entities or the registry of securities owners;
- the threat of violence to the victim of raiding;
- falsification of the decision of the general assembly of shareholders or decision of the board of directors of a company;
- the deliberate distortion of voting results in the general assembly of shareholders.

Thus currently the Russian Federation has the requisite legislative mechanisms to effectively counter the raider attacks through the use of bankruptcy procedures. These legislative changes have led to a situation where, for the most part, raiders make use of weaknesses of the corporate legislation rather than the bankruptcy legislation.

Premeditated bankruptcy and abuse by insolvency practitioners

The Law on Bankruptcy defines bankruptcy as the debtor's inability to fully satisfy the monetary claims of creditors of monetary obligations and/or to make obligatory payments as recognised by the court of arbitration. The purpose of the bankruptcy procedure for creditors is as complete and equitable satisfaction of their claims as possible and for the debtor – the possibility to be freed from debt.

However, in some cases, unscrupulous economic operators use bankruptcy proceedings illegally, thus causing damage to contractors. In order to evade the obligations, assets of the enterprise are either removed or significantly reduced. As a result the company cannot repay its debts, and legitimate lenders are deprived of the opportunity to receive money owed to them.

With regard to liability (criminal), the Criminal Code places responsibility on the manager or founder (participant) of the legal entity for acts defined in the Article 196 “premeditated bankruptcy” and Article 197 “fictitious bankruptcy”.

The legal definition of premeditated bankruptcy is contained in Article 14.12 of the Code of Administrative Offences and Article 196 of the Criminal Code. Premeditated bankruptcy represents actions (inaction) of a manager or founder (participant) of a legal entity or an individual entrepreneur knowingly resulting in the failure of a legal entity or an individual entrepreneur to fully satisfy the monetary claims of creditors and (or) fulfil the obligation to pay obligatory payments. The type of liability (criminal or administrative) depends on the size of the damage caused by these actions.

In addition, in accordance with part 4 Article 10 of the Law on Bankruptcy, the debtor's bankruptcy caused by participants, the owner of the property of the debtor or other persons, including the manager of the debtor, who have the right to give binding instructions to the debtor or to otherwise determine its activity may lead to the default (optional) liability of these individuals for the debtor's obligations. For example, a director of the company, whose actions have led to bankruptcy, may be liable with all of his/her personal means and assets for the outstanding amount payable by the enterprise-debtor.

In accordance with the decision of the Government of the Russian Federation No. 855 of December 27, 2004, the insolvency practitioner shall detect indications of premeditated bankruptcy. This is done through the analysis of the constituent documents, financial statements, contracts for the alienation of the property of the debtor, and the analysis of other relevant information. The period of verification shall be not less than two years prior to the commencement of the bankruptcy case.

Based on the results of the audit, the insolvency practitioner draws a conclusion on the existence/absence of indications of premeditated bankruptcy. This conclusion is presented to the assembly of creditors, the arbitration court, and the bodies with authority to file protocols of administrative offences. In cases of major damage, the information shall be sent also to the bodies of preliminary investigation (Section 15 of the Decision No. 855 of December 27, 2004).

The insolvency practitioner is a key figure in the bankruptcy case. The law grants him/her considerable powers and a number of key responsibilities, including maintaining of the register of creditors' claims and the protection of the debtor's property. An insolvency practitioner is required to act in good faith and reasonably in the interests of the debtor, creditors and company (Article 20.3 of the Law on Bankruptcy). Given the wide powers of the insolvency practitioner, unscrupulous participants of bankruptcy cases make great efforts to achieve the appointment of an insolvency practitioner who is under their control. This is done in order to carry out illegal appropriation of property and obstruct the rights of bona fide creditors.

The legislation establishes liability of an insolvency practitioner for the violation or improper discharge of his/her duties during the bankruptcy proceedings. The insolvency practitioner:

1. May be removed by the court of arbitration from his/her duties (Article 20.4 of the Law on Bankruptcy);
2. Shall be brought to administrative responsibility in accordance with Article 14.13 of the Code of Administrative Offences;
3. May be subjected to disciplinary measures, including exclusion from a self-regulatory organisation of insolvency practitioners (hereafter – SRO);
4. May be prosecuted based on provisions of the Criminal Code.

Box 10. Example of a crime of an insolvency practitioner

In one bankruptcy case, the insolvency practitioner gave an instruction to enter false information in the accounting documents about the existence of a large debt payable to a company, which provided services to the debtor plant. The plant paid a large sum based on a fictitious contract and the legitimate creditors suffered major damage. The court found the former insolvency practitioner guilty

of misconduct in bankruptcy proceedings that caused major damage (part 1 Article 195 of the Criminal Code).

Bankruptcy creditors may submit a civil claim against the insolvency practitioner who may be liable for damages caused by non-performance or improper performance of his/her duties in the bankruptcy case. Since actions of the practitioner in a bankruptcy case are not considered entrepreneurial activity, the presence of his/her guilt is a prerequisite for the liability for damages. Such claims by bankruptcy creditors are considered outside the bankruptcy case.

Appointment and removal of an insolvency administrator

Procedure for the appointment of an insolvency practitioner consists of several stages. The bankruptcy procedure begins with a statement in the court of arbitration by a creditor, tax authority or the debtor. The statement shall specify a particular candidacy of insolvency practitioner or the SRO from whose members the insolvency practitioner shall be proposed for approval. Then the court sends a request to the selected SRO on a candidacy of an insolvency practitioner or on the correspondence of the specified candidate with existing requirements.

Procedure for the appointment of an insolvency practitioner is somewhat different during the transition from temporary to external observation or bankruptcy proceedings or when there is a separate decision of the creditors assembly on replacing the insolvency practitioner. The process of the appointment of the insolvency practitioner originates from the receipt by the court of the protocol of the creditors assembly with a specified SRO or a particular candidate of the insolvency practitioner. Then the court directs a request to the SRO on the candidacy of the insolvency practitioner as specified in the protocol of the creditors' assembly. The SRO shall inform the court about the correspondence of the specified candidate with legal requirements. The court shall review the information and, based on the review, appoint such practitioner who corresponds to the requirements.

The Law on Bankruptcy governs the removal of an insolvency practitioner. Any participant of a bankruptcy case may apply to the court with a request to remove the practitioner from duty. The non-fulfilment or improper discharge of the practitioner's duties as stipulated in the Law on Bankruptcy constitutes grounds for his/her removal.

Moreover the insolvency practitioner shall be subject to removal by the court when he/she has been subject to measures of administrative liability in the form of disqualification or upon identification of circumstances that would preclude the appointment of a person as an administrator as well as when such circumstances have arisen after the appointment.

4.5.2 International standards

Several sources of non-legislative recommendatory guidance exist regarding insolvency proceedings. This brief review will show those aspects of the guidance that relate to the governance of the profession of insolvency practitioners, in particular the regulatory and control role of public authorities.

The World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights cover a wide range of issues, among other things, concerning the institutional and regulatory framework for the implementation of the insolvency system. For example, regarding the role of courts, the Principle 27 recommends:

“Bankruptcy cases should be overseen and disposed of by an independent court or competent authority and assigned, where practical, to judges with specialised bankruptcy expertise. Significant benefits can be gained by creating specialised bankruptcy courts. The law should provide for a court or other tribunal to have a general, non-intrusive, supervisory role in the rehabilitation process. The court/tribunal or regulatory authority should

*be obliged to accept the decision reached by the creditors that a plan be approved or that the debtor be liquidated.*²⁴²

Two of the principles (34 and 35) that are recommended regarding insolvency administrators are as follows:

“The body or bodies responsible for regulating or supervising insolvency administrators should be independent of individual administrators and should set standards that reflect the requirements of the legislation and public expectations of fairness, impartiality, transparency and accountability”;

“Insolvency administrators should be competent to exercise the powers given to them and should act with integrity, impartiality and independence.”²⁴³

The EBRD Insolvency Office Holder Principles²⁴⁴ contain a number of provisions, which concern the role of public authorities. Thus, when it comes to the appointment of insolvency office holders, in the case of appointment by a court [or other relevant authority], clear guidelines concerning the manner in which the court should select such an office holder are recommended. It should be possible to appeal against the appointment of a particular office holder to a court or other relevant authority. A government or other body should be provided with appropriate regulatory, investigatory and disciplinary powers in respect of office holders. Extensive recommendations are provided also in the UNCITRAL Legislative Guide on Insolvency Law.²⁴⁵

4.5.3 Council of Europe member states

Insolvency practitioners have a central role in ensuring that creditors are ensured due protection of their interests while debtors have their solvency restored in the most efficient way. They have wide authority in handling property of the debtor. Moreover, as the experience shows, insolvency proceedings are a common and crucial step in illicit takeover schemes. Insolvency practitioners are persons who can make the realization of certain illicit activity more difficult. Therefore their integrity is of paramount importance. Various countries have different systems for the organisation and supervision of the profession.

Different European countries regulate the profession of insolvency practitioners differently. In some countries, any person who corresponds to certain qualification criteria may administer insolvency processes. Moreover in such countries a judge often enjoys a wide discretion in the choice of such person to fill the post of the insolvency administrator whom the judge deems capable and suitable. In other countries the profession is strictly regulated and registries or rosters of licensed individuals are used.²⁴⁶

Between 2003 and 2009, 11 member States of the European Union introduced rules containing requirements for entry in the profession of insolvency practitioner. 12 member States of the European Union (Bulgaria, the Czech Republic, Estonia, France, Latvia, Lithuania, Poland, Portugal, Romania, Slovakia, Slovenia, and the United Kingdom) require passing of a professional exam. Cited reasons for the reforms have been the increasing scope and complexity of tasks, increase in the number of trans-border insolvency procedures, implementation of the Council Regulation (EC) No 1346/2000 on

²⁴² The World Bank (2001) *Principles and guidelines for effective insolvency and creditor rights systems*, p. 11 available at www.worldbank.org/

²⁴³ The World Bank (2001) *Principles and guidelines for effective insolvency and creditor rights systems*, p. 12, available at www.worldbank.org/

²⁴⁴ European Bank for Reconstruction and Development (2007) *EBRD Insolvency Office Holder Principles*, available at www.ebrd.com/

²⁴⁵ United Nations (2005) *Legislative Guide on Insolvency Law*. available at www.uncitral.org/

²⁴⁶ The Ministry of Justice of the Republic of Latvia (2013) [Informatīvais ziņojums „Par maksātnespējas procesa administratoru darbības uzraudzības sistēmas pilnveidošanu], p.8. available at www.mk.gov.lv/

insolvency proceedings and increasing importance of insolvency rights in the common market.²⁴⁷ Systems without a list (roster) of insolvency practitioners tend to be in countries where judges have wider discretion in deciding on the appointment of the administrator based on general legal clauses in specialised insolvency or commercial courts.

Three models of supervision are found in member States of the European Union. Insolvency practitioners can be supervised primarily by:

- Specialised insolvency courts or court officials who are trained for the supervision of insolvency proceedings (Belgium, Germany, the Netherlands, the United Kingdom);
- Authorised State body (Finland, Latvia, Lithuania, Sweden);
- Creditors' assembly or creditors' committee (Estonia).²⁴⁸

Note that, regardless of the model, courts will also have control functions especially with regard to particular bankruptcy proceedings (as opposed to the more general professional oversight of practitioners, which can be ensured by other bodies). In some countries professional organisations (licensing bodies) play a major oversight role, for example, in the United Kingdom.

Further the chapter will look into the situation of four member States of the Council of Europe – Finland, Germany, Latvia, and Ukraine. Each country is examined separately using the following format:

Supervision over insolvency practitioners: Here the powers of those authorities will be reviewed, which have a primary role in supervising the work of practitioners.

Selection of an insolvency practitioner for a particular case: The main principles of selection will be reviewed here.

Finland

Supervision over insolvency practitioners: The Bankruptcy Ombudsman, attached to the Ministry of Justice, supervises the administration of bankruptcy estates (along with the creditors, the Finnish bar Association and the Chancellor of Justice). The duties of the Ombudsman are, among other things, to supervise that bankruptcy estates are administered in a lawful and proper manner and that the estate administrators appropriately fulfil the duties entrusted to them as well as to undertake the necessary measures as regards omissions, transgressions and other comparable circumstances that have come to his knowledge (Article 1, Paragraphs 1 and 2, Act on the Supervision of the Administration of Bankruptcy Estates).²⁴⁹ The Bankruptcy Ombudsman was introduced in 1995 based on, among other things, a concern that the creditors' control and supervision by the Finnish Bar Association over the conduct of its members was insufficient.²⁵⁰

The Ombudsman may turn to the court and demand:

- that the administrator who has neglected his/her duties either remedies the failure or faces a fine;
- that the administrator is dismissed from his duties, if the administrator has essentially neglected his duties or for other weighty reasons;
- that the administrator's fee must be reduced if he has significantly failed to perform his duties or if the fee clearly exceeds what can be deemed reasonable (Article 7, Paragraphs 1-3).

²⁴⁷ Inacio, E. (2009) *Regulating the Profession of Insolvency Practitioners within the European Union*. Cited from: The Ministry of Justice of the Republic of Latvia (2013) [[Informatīvais ziņojums „Par maksātnespējas procesa administratoru darbības uzraudzības sistēmas pilnveidošanu](#)], p.8, available at www.mk.gov.lv/lv/

²⁴⁸ The Ministry of Justice of the Republic of Latvia (2013) [[Informatīvais ziņojums „Par maksātnespējas procesa administratoru darbības uzraudzības sistēmas pilnveidošanu](#)], pp.8,21, available at www.mk.gov.lv/

²⁴⁹ *Act on the Supervision of the Administration of Bankruptcy Estates*, available at www.konkursisiamies.fi/

²⁵⁰ Vatanen, M. (2005) *Liability and Supervision of Administrators of Bankruptcy Estates in Finland*, available at www.insol-europe.org/

Dismissal of the administrator can also be requested by the debtor or the creditor (Chapter 8, Article 6, Bankruptcy Act).²⁵¹

Selection of an insolvency practitioner for a particular case: Overall Finland is a country with a liberal approach to the profession of insolvency practitioners. No licences are required although usually they are lawyers and also members of the Finnish Bar Association.²⁵² It is required that the administrator consents to the appointment, “has the ability, skills and experience required for the duty, and is also otherwise suitable for the duty” (Chapter 8, Article 5, Bankruptcy Act). Usual conflict-of-interest provisions apply to the relationship between the administrator and the debtor or the creditor. In practice, the administrator is usually proposed by the creditor or the debtor. While not bound by the proposal, the court usually follows it.

Germany

Supervision over insolvency practitioners: The insolvency administrator shall be subject to supervision by the insolvency court (Article 58, Paragraph 1, Insolvency Statute).²⁵³ According to Heinz Vallender “usually the insolvency court will not interfere with the actions of the insolvency administrator, especially not, if a creditors’ committee has been installed, which is supposed to both support and supervise the administrator on its own”.²⁵⁴ The court may require the administrator at any time to give specific information or to report on the progress of the proceedings and on the management. If the administrator does not fulfil his/her duties, subsequent to a warning the court may impose an administrative fine on him/her (Article 58, Paragraphs 1 and 2). The insolvency court may dismiss the administrator for an important reason (on own initiative or at the request of the administrator, of the creditors' committee or of the creditors' assembly) (Article 59, Paragraph 1), e.g. if he/she has committed a breach of duty. Such breach must be proved to the full conviction of the court (exceptionally the dismissal is possible if only particular clues of the breach exist when only dismissal can avert a significant threat).²⁵⁵

Selection of an insolvency practitioner for a particular case: From among all those persons prepared to take on insolvency administration work, the insolvency court shall select and appoint as insolvency administrator an independent natural person who is suited to the case at hand, who is particularly experienced in business affairs and independent of the creditors and of the debtor (Article 56, Paragraph 1). However, the creditors have procedures to propose or replace the insolvency administrator. The court may refuse / overrule such election if the person is unsuited to assume such an office (Article 56a, 57). Overall the judges have a fairly broad margin of appreciation in their decisions. In the past, there have been concerns that, due to very scarce procedures, not all suitable professionals have been ensured a fair chance to be appointed.²⁵⁶

Latvia

Supervision over insolvency practitioners: A person who satisfies a number of criteria established in the law must pass an exam and obtain a certificate from the Administrators Association. In the past, in Latvia supervision of the legality in the insolvency proceedings was primarily the competency of the court. In an effort to reduce the burden on the courts, this function was laid primarily with the Insolvency Administration (with the courts retaining control functions over certain decisions). The Insolvency Administration carries out its supervision functions through reviewing complaints about action of an administrator or on its own initiative.²⁵⁷ The Insolvency Administration may demand

²⁵¹ *Bankruptcy Act*, available at www.finlex.fi/

²⁵² Vatanen, M. (2005) *Liability and Supervision of Administrators of Bankruptcy Estates in Finland*, available at www.insol-europe.org/

²⁵³ *Isolvezordning*, available at <http://dejure.org/>

²⁵⁴ Vallender, H. *Selection of insolvency practitioners and supervision by the court in Germany*, available at www.insol-europe.org/

²⁵⁵ *Bundesgerichtshof. Beschl. v. 08.12.2005*, Az.: IX ZB 308/04, available at www.jurion.de/

²⁵⁶ Vallender, H. *Selection of insolvency practitioners and supervision by the court in Germany*, available at www.insol-europe.org/

²⁵⁷ The Ministry of Justice of the Republic of Latvia (2013) [Informatīvais ziņojums „Par maksātnespējas procesa administratoru darbības uzraudzības sistēmas pilnveidošanu], p.21, available at www.mk.gov.lv/

information, documents and explanations about proceedings and the administrator's actions within particular proceedings, impose legal obligations on the administrator, propose to the court to dismiss the administrator as well as propose the termination or cancellations of the administrator's certificate (Article 174, Paragraph 2, Insolvency Law).²⁵⁸

Selection of an insolvency practitioner for a particular case: Also in Latvia the court appoints insolvency administrators (Article 19, Paragraph 1). However, the appointment is done based on proposal by the Insolvency Administration, which chooses the candidate from a list of candidates (Article 2, Procedure on how the Insolvency Administration Selects and Proposes to the Court a Candidate for the Post of the Administrator of Insolvency Proceedings).²⁵⁹ The order of candidates and the order in the list of persons/entities available for administration are random (Articles 4.¹ and 9) and hence the proposal made by the Insolvency Administration shall be random. In case of disqualification of a particular administrator, he/she shall send a refusal to the Insolvency Administration (Article 12).

The selection system was amended in the end of 2013 in order to strengthen the element of randomness. The change was a part of the reaction against suspected collusion between particular insolvency administrators and particular judges engaging in allegedly fraudulent activity.²⁶⁰

Ukraine

Supervision over insolvency practitioners: The Ukrainian law foresees a possibility for the State Body on Bankruptcy Issues to carry out scheduled checks on arbitration practitioners no more often than once in two years. The practitioner is obliged to present to persons authorised to carry out the check information, documents and copies of documents. It is prohibited to carry out a repeated check concerning the same questions that have already been subject to check earlier. The same applies to past periods already covered by checks unless based on applications of physical persons or legal entities.

Unscheduled checks are carried out based on applications of citizens or legal entities if such applications show the necessity to carry out additional control by the State Body on Bankruptcy Issues. (Article 106, Paragraphs 1 and 2, law On the Restoration of the Solvency of the Debtor or Recognition of His Bankruptcy).²⁶¹ In case violations are found, the State body may suspend the activity of the practitioner and hand over materials for the review of a disciplinary commission for the application of disciplinary penalties (Article 106, Paragraph 3).

Apart from the mentioned checks, courts and the self-regulation organisations of arbitration administrators carry out control functions.

Selection of an insolvency practitioner for a particular case: A candidacy of a practitioner for the realization of the function of the receiver ("*розпорядник майна*") is chosen by the court independently with the help of an automated system from a circle of persons entered in the unified register of arbitrage administrators of Ukraine. Upon receipt of an application for a bankruptcy case, the court obliges an administrator determined by the automated system to apply for participation in the particular case. If the determined administrator does not apply, the court appoints an administrator from the register without using the automated system.

For the function of a rehabilitation administrator or liquidator, the court decides on the candidate based on a petition by the creditors' committee or, if no such committee exists, on own initiative except cases set in the law. However, the proposal of candidates is not binding for the court. The

²⁵⁸ [*Maksātnespējas likums*], available at <http://likumi.lv/>

²⁵⁹ [*Kārtība, kādā Maksātnespējas administrācija izvēlas un iesaka tiesai maksātnespējas procesa administratora amata kandidātu*], available at <http://likumi.lv/>

²⁶⁰ Sprance, I. (2013) *Ceļojošais cirks*. Ir, 4-10 April, pp. 12-17.

²⁶¹ *The Law of Ukraine On restoring the debtor's solvency or declaring bankruptcy*, [*Закон України О відновленні платіжеспособності должника или признании его банкротом*] available at <http://uazakon.ru/>

rejection of the proposed candidates and appointment of a different administrator must contain a statement of reasons (Article 114, Paragraph 1).

The court may dismiss the administrator in cases of:

- 1) failure to fulfil or inadequate fulfilment of duties;
- 2) misuse of the rights of the administrator;
- 3) submission of false information to the court;
- 4) refusal to grant permission to access the State secret or cancellation of a permission granted earlier;
- 5) termination of the activity of the administrator (Article 114, Paragraph 3).

4.5.4 Conclusions

The misuse of bankruptcy proceedings has been one of the most common approaches of illegal corporate raiding in the Russian Federation and other countries. The current Russian legislation contains no legal definition of the terms “raider” or “raider seizure”. Neither does the bankruptcy legislation define abuses of bankruptcy procedures to capture companies. Nevertheless over years, with a number of legislative changes (e.g. establishing the business owner as one of the parties to a bankruptcy case), the Russian Federation has established fairly effective legislative mechanisms to counter the raider attacks through the use of bankruptcy procedures.

The legislation defines liability and accountability of insolvency practitioners. However, given the wide powers of the insolvency practitioner, unscrupulous participants of bankruptcy cases do make great efforts to achieve the appointment of an insolvency practitioner who is under their control. This is done in order to carry out illegal appropriation of property and obstruct the rights of bona fide creditors. Such problems, even if not widespread, attest to the lacking integrity of some insolvency practitioners and possibly also the need to further strengthen the supervision of the profession in practice.

The overview of several European countries shows a variety of approaches toward rules on entry into the profession of the insolvency administrator (with or without exams and certification) and distribution of responsibility for the control over the administrators (with or without specialised control bodies). Moreover the level of discretion in the appointment of the administrator in particular cases is widely varied. A variation is seen also in the extent to which the creditor or debtor can influence the choice.

5 ADMINISTRATIVE PROCEDURE

5.1 Registration of legal entities

Legitimate control and assets of companies can be placed in jeopardy when public registration systems either preclude timely and precise registration or do not ensure due protection against fraudulent actions, e.g. when it is too easy to make some registration entry with the help of falsified documents / signatures and no quick methods are available for rectification. As a part of their takeover effort, illegal corporate raiders may seek the registration of changes in the founding documents of an entity, in the allocation of ownership rights, in the list of appointed company managers and authorised persons, etc. Particularly, in the case of illegal raiding, such attempts may be based on counterfeited documents, which purportedly attest a certain corporate decision, or on decisions, e.g. concerning the replacement of company management, which have been reached through breaches of legal procedures and/or company statutes. In such cases, the registration authorities are tricked into making certain entries.

A different type of situations involves malicious acts on the part of officials of the registration authorities. The principal varieties of this category are a collusion between the corrupt officials and the private persons (e.g. raiders who attempt the illegal acts) and situations when the officials try to raise illicit benefits on their own initiative (e.g. by demanding bribes for the execution of legitimate requests). Typically the interest of illegal raiders will focus on registries of legal entities but may also target registries of real estate, securities, vehicles, credits, etc. As a matter of example concerning Azerbaijan, in 2013 the US State Department noted allegations that “approximately 20,000 persons in 400 buildings had lost their residences and been unfairly compensated in Baku over the previous two years”.²⁶² The report also referred to major bribes needed to register buildings.

Inadequate protection of certain private information in the registry of legal entities may also provide possibilities of abuse.²⁶³ However, difficult access to the data represents a far more common facilitator of abuse.

5.1.1 The Russian Federation

The general procedure of the State registration of legal entities and individual entrepreneurs is set by the Federal Law №129-FZ of August 8, 2001 “On the State registration of legal entities and individual entrepreneurs”. Particular rules are contained also in the Civil Code (Articles 23 and 51) and in other regulatory legal acts. Particularities of registration of different kinds of legal persons are determined by the relevant federal laws.

General liability of registry officials: Article 24 of the law №129-FZ establishes the liability of officers of registering bodies for the unjustified refusal of State registration, failure to comply with State registration deadlines or other violation of the order of the State registration, as well as unlawful denial or untimely provision of information and documents, which are contained in the public registers. The registration authority shall compensate for the damage caused by the denial of State registration, avoidance of State registration or violation of the order of the State registration, which took place due to its fault.

The Code of Administrative Offences in parts 1 and 2, Article 14 establishes the responsibility of officers carrying out the State registration for late or inaccurate recording of a legal entity or an individual entrepreneur in the single State register and for unlawful denial or untimely provision from the unified State Register of information and/or other documents to persons interested in receiving such information and/or documents.

²⁶² US Department of State (2013) [Investment Climate Statement – Azerbaijan](http://www.state.gov/). available at www.state.gov/

²⁶³ Drawn from: Zimmerer, G. (2012) [Raider Attacks in Ukraine](http://ti-ukraine.org/), p.4. available at <http://ti-ukraine.org/>

Liability for falsification: The Federal Law №147-FZ of July 1, 2010 tightened the prosecution for falsifying and destruction of documents (including electronic) such as single State registers, registers of holders of securities, depository accounting system, decisions of the board of directors (supervisory board) and the general assembly of shareholders (participants) of a company.

The Article 170.1 was introduced in the Criminal Code to provide liability for the “falsification of the unified State register of legal entities, the register of holders of securities or system of depository accounting”.

Box 11. Example of an attempt to register false information

An example of judicial case law on the subject of falsification is the cassation decision of September 19, 2012 in the case N 22-1843 on submission to the Federal Tax Service of documents containing deliberately false information with a view to enter into the unified State register of legal entities inaccurate information about the head of a standing executive organ of the legal person, on the size and nominal value of the shares of participants in the share capital of the company. The Court left the verdict in the case unchanged.

The Article 185.5 provides liability for forgery of the protocols of the general assembly or the board of directors, for entering of knowingly false information in other documents that reflect the progress and results of the vote if the falsification of documents was made “in order to illegally gain control in the legal entity”.

The Article 285.3 prescribes liability for “intentional introduction by an official in one of the unified public registries under the legislation of the Russian Federation deliberately false information as well as deliberate destruction or forgery of documents, on the basis of which an entry or change was made in the unified State registers if the mandatory storage of the documents is provided for by the legislation of the Russian Federation”.

Box 12. Example of a raiding attack with the involvement of a registration authority

A huge public outcry was caused by a raider attack with participation of government authorities in Moscow on the joint-stock company “ZZZ”. The attack was carried out based by producing of a copy of the certificate of ownership of a building. When details about the new owners were requested, the registration authority confirmed that a re-registration of ownership rights to the property did take place. When the file was requested, it appears that such file did not exist. The person who carried out the registration had quit the job immediately after the transaction was finished.

The need for such changes in legislation shows that falsification of documents of a company is one of the common means of raider attacks. Also falsification of electronic data in the unified State registers with the simultaneous destruction or forgery of paper documents that are the basis for changes in the e-part of the register has become common.

Liability of private persons: Article 25 of the law №129-FZ and part 3 of Article 14.25 of the Code of Administrative Offences establish the liability of legal persons and individual entrepreneurs for failure to submit or late submission of the information required to be included in the public registries, as well as for submission of incorrect information. In the paragraph 3 of the Decision of the Plenum of the Supreme Court of the Russian Federation from November 18, 2004 N 23, it is stated that documents containing false information are documents containing such false or misleading information, which resulted in the ungrounded registration of a business entity.

If, upon creating a legal entity, repeated or gross violation of the law or other legal acts, including of irreparable character, have taken place, the registration authority may apply to the court demanding the liquidation of the legal person (see the Appendix 2 for more information). On similar grounds, a request can be made to terminate the activities of a natural person as a sole proprietorship.

Russian law provides for administrative, tax and criminal liability for offences committed by legal persons or individual entrepreneurs in relation to their late registration. Administrative responsibility for violations in the sphere of entrepreneurship can be applied to citizens, officials, legal persons, individual entrepreneurs. Moreover the Code of Administrative Offences equates individual entrepreneurs to officials. Article 15.3 of the Code of Administrative Offences establishes liability for violation of the deadline of application for registration with the tax authority as well as responsibility for the same, if actual activity was carried without registration with the tax authority. Fiscal liability is enshrined in Article 116 of the Tax Code.

Criminal liability is established under Article 171 of the Criminal Code for the realization of enterprise activity without registration or licence, if that activity has caused major damage or is associated with the gain of large proceeds. Still, at least in the past, the Article has been misused to charge entrepreneurs with heavy offences for seemingly minor violations in the paperwork.²⁶⁴

Finally it should be noted that, apart from the mere registration procedure, a wide variety of disputable situations arise in relation to the reorganisation of legal entities. See their list in the below box.

Box 13. Disputable situations in the reorganisation of legal entities in the Russian Federation

Based on the analysis of current judicial and arbitration practice in the Russian Federation, one can identify a number of types of major disputable situations connected with the reorganisation of legal entities:

- No notification to creditors within the statutory period;
- Violation of the rights of minority shareholders (participants) to obtain information about the reorganisation;
- Violation of the property rights of the minority shareholders (participants) who voted against the reorganisation or did not participate in the assembly where it was decided to reorganise;
- Procedural irregularities in the conduct of the general assembly of shareholders (participants) in the course of the reorganisation, absence of a quorum, signing of the minutes of the assembly by an unauthorised person, violation of the modalities for the preparation of the general assembly of shareholders (participants), etc.;
- Violation of the order and timing of the issuance of shares during the procedure of reorganisation;
- Abuse of the right to reorganisation, i.e. participants of the legal entity carry out the reorganisation with the sole purpose of avoiding tax and other obligations at a time when an insolvency claim has been already submitted to the court concerning the particular legal entity. Use of the reorganisation procedure in such case is motivated solely by the wish of the participants to avoid civil liability (for example, when reorganisation is carried out in the form of separation (segregation), the redistribution of assets is possible in such a way that one of the legal entities obtains most of the assets while the other entity (or entities) keeps only the debts);
- Violation of the competition law (when a monopolistic company is created) when bodies of the Federal Antimonopoly Service apply to the court of arbitration to force the reorganisation of legal persons as separation (segregation) in order to maintain competition in the product market;
- Violation of the legislation on State registration by the registration authorities (tax authorities and judicial institutions) upon registration actions related to the reorganisation;
- Reinstatement of the rights of corporate control upon recognition of the reorganisation as illegal.

²⁶⁴ Firestone, T. (2010), [Armed Injustice: Abuse of the Law and Complex Crime in Post-Soviet Russia](http://djilp.org/), available at <http://djilp.org/>

5.1.2 Council of Europe member states

In the context of corporate conflicts and forced takeovers, an important point of struggle and controversy is registration of companies and data concerning among other things their owners and directors. The precise functions of registries and status of the registered data vary from country to country. However, they usually serve to provide certain information about the legal entities to third persons, to a stronger or weaker degree certify legal relationships of the entity and to a stronger or weaker degree allow for the control of the registrar over the procedural or material correctness of the entries. This part of the paper will provide a brief overview on control procedures to ensure correctness of the registered data, procedures to challenge the data and access to the registry.

Control of correctness

Registration of changes in, for example, the board of directors of a company or registered capital can affect interests of various persons. Therefore it is important that any change in entries reflect decisions made by legally authorised persons in correct procedure. However, requiring the registrar to verify fully the legality of documents, on which the request of entry is based, may constitute a major burden and, by prolonging the process, create a considerable drag on legitimate business. The existing approaches in the reviewed countries show a certain variety.

In **Germany**, the key provision in this regard is the requirement that a submission for entry in the commercial register shall be made electronically in an officially certified format. A legal successor of a participant shall prove the legal succession as far as possible with official documents (Article 12, Paragraph 1, “*Handelsgesetzbuch*”).²⁶⁵ The obligation of the Registration Court to verify the contents of the information is limited in that the court is required to make inquiries only when it is to decide a matter rather than just enter information in the register (Article 26, Law on the Procedure in Family Matters and Matters of Non-contentious Jurisdiction).²⁶⁶ Otherwise the check focuses on whether, on the face of it, formal requirements have been fulfilled, e.g. whether the list of participants of a limited company contains names, birthdates, places of residence, nominal amounts and numbers of transferred shares are shown (Article 40, Paragraph 1, Limited Liability Companies Law).²⁶⁷

The reliability of the process largely rests on the requirement of notarization, e.g. in the transfer of shares of limited liability companies (Article 15). Particular standards apply to the founding of a joint-stock company where the court shall check whether the company has been set up and notification is made in accordance with the procedure (Article 38, Paragraph 1, Stock Corporation Law)²⁶⁸ (with regard to limited companies the court shall simply turn down the entry if the company is not set up according to procedure). Under certain circumstances, upon founding of a joint-stock company, participation of a notary or court-appointed foundation auditor is required (Article 33).

In **Latvia**, the Commercial Law provides an extensive list of documents that shall bear notarial verified signatures. For example, such verification is required on protocols of participants’ or shareholders’ meetings if it is decided to appoint or recall a board member or, in the case of a joint-stock company, a member of a supervisory board, or to amend company statutes (Article 10, Paragraph 2, Commercial Law).²⁶⁹ The requirements were strengthened in 2013 with the intent to limit risks of illegal corporate raiding. Meanwhile the court has affirmed on several occasions that the Register of Enterprises shall not verify the actual circumstances, under which documents submitted to it have been formed. Rather just compliance with legal standards shall be checked.²⁷⁰

²⁶⁵ *Commercial Law [Handelsgesetzbuch]*, available at <http://dejure.org/>

²⁶⁶ *Act on Proceedings in Family Matters and in Matters of Voluntary Jurisdiction [Gesetz über das Verfahren in Familiensachen und in den Angelegenheiten der freiwilligen Gerichtsbarkeit]* available at <http://dejure.org/>

²⁶⁷ *Company Law, [GmbH-Gesetz]*, available at <http://dejure.org/>

²⁶⁸ *Stoke Corporation Act, [Aktiengesetz]*, available at <http://dejure.org/>

²⁶⁹ *[Komerclikums]*, available at <http://likumi.lv/>

²⁷⁰ Paegle, A. (2012), *The latest administrative court practices relating to the Register of Enterprises competence [Jaunākā administratīvās tiesas prakse saistībā ar Uzņēmumu reģistra kompetenci]* Jurista Vārds, available at www.ur.gov.lv/

In **Norway**, the text of the law foresees *prima facie* stricter standard. The registrar shall verify whether what is submitted for registration and its grounds correspond with law and have been made in accordance with law. If the enterprise's statute is already registered, the registrar shall also verify if the submission corresponds with the statute. The registrar is authorised to request such information as is necessary for the verification. If the registrar finds that the registration may violate right of third persons, he shall provide them with a possibility for expression (Article 5-1, Law on the Registration of Enterprises).²⁷¹ Meanwhile requirements of notarial certification are limited in Norway.

In **Ukraine**, documents such as a copy of the decision of the founders has to be certified by a notary in cases foreseen in the law (Article 24, Paragraph 1, Law on the State Registration of Legal Entities and Physical Persons – Entrepreneurs)²⁷²; the same applies, for example, to the decision to amend founding documents (Article 29, Paragraph 1). The registrar is explicitly prohibited from requesting documents other than those listed in the law (Article 24, Paragraph 8; Article 29, Paragraph 7). The registration of an entity or changes in the founding documents of an entity can be refused based on a number of procedural and material reasons (Article 27) but the verification is by and large confined to information confined the Unified State Register (Article 25, Paragraph 2; Article 31, Paragraph 5). However, overall the detailed regulation on the certification of documents and verification of the identity of the person submitting certain documents, e.g. for amending the founding documents of an entity (Article 29, Paragraph 8) aim at ensuring that the registrar's means of verification are sufficient.

As part of anti-raiding measures, handling of registers of shareholders of companies where the State owns more than 50% of stake was entrusted to a company set up by the Cabinet of Ministers and correspondingly licensed by the State Commission on Securities and Stock Market.²⁷³

Some countries have introduced even more specific requirements against illegal takeovers. Thus, in the beginning of 2012, **Moldova** adopted legislative amendments stipulating that transfer of capital shares of a commercial bank from one individual to another is only possible with an advance permission from the National Bank and based on a final court decision.²⁷⁴

Procedures to challenge entries

In the context of corporate conflicts and forced takeovers, a relevant issue is possibilities for third persons whose interests may be violated to challenge entries that have been made in the registries. Meanwhile it is important to bear in mind that in many systems for various types of legal relationships, the registration is merely a tool to make the relationships known to third parties. Hence the registration as such does not render an illegal act legal.

In **Germany** entries in the Commercial Register cannot be challenged as such (Article 383, Paragraph 3, Law on the Procedure in Family Matters and Matters of Non-contentious Jurisdiction).²⁷⁵ However, the court has the authority to delete an entry because of a missing essential prerequisite upon own initiative or application from a professional organ (Article 395, Paragraph 1).

In **Latvia**, decisions and actions of officials of the commercial registration authority may be contested with the Chief State Notary of the Register of Enterprises (contesting of a decision shall not suspend the execution thereof). The decisions and actions of the Chief State Notary of the Register of Enterprises may be appealed to the administrative court (Article 19, Law on the Enterprise Register of the Republic of Latvia).²⁷⁶ An important provision, in the context of prevention of fraudulent acts, is the requirement that the State notary of the Enterprise Register shall take a decision on refusal to

²⁷¹ Law on Company registration, [*Lov om registrering av foretak*] available at <http://lovdata.no/>

²⁷² The law on state registration of legal entities and individuals - entrepreneurs [*Закон Про державну реєстрацію юридичних осіб та фізичних осіб – підприємців*]. available at <http://zakon0.rada.gov.ua/>

²⁷³ LIGA Business Inform (2013). *The President signed the anti-raider law* [*Президент підписав антирейдерський закон*]. available at <http://biz.liga.net/ekonomika/>

²⁷⁴ Stepanov, G. (2012) *Moldovan Parliament adopted the "anti-raider law* [*Парламент Молдови прийняв „антирейдерський закон*]. Noi.md, available at www.noi.md/

²⁷⁵ Act on Proceedings in Family Matters and in Matters of Voluntary Jurisdiction [*Gesetz über das Verfahren in Familiensachen und in den Angelegenheiten der freiwilligen Gerichtsbarkeit*], available at <http://dejure.org/>

²⁷⁶ [*Likums Par Latvijas Republikas Uzņēmumu reģistru*] available at <http://likumi.lv/>

register (attach to the file) documents or to make an entry in the Commercial Register if unequivocal evidence has been submitted to the Enterprise Register, attesting to the fact that a signature has been forged (Article 14).

In **Norway**, the registrar's decision can be appealed to the ministry by anyone who has a legal appeal-interest in the case. The law prescribes a strict timeframe for the appeal (three weeks after the notification has arrived to the person or the person has/ should have learnt about the decision, in any case not exceeding three months from the decision (Article 9-1, Law on the Registration of Enterprises).²⁷⁷

In **Ukraine**, the law contains a general provision allowing for appeal in the court against action or a failure to act by a State registrar (Article 53, Paragraph 2, Law on the State Registration of Legal Entities and Physical Persons – Entrepreneurs).²⁷⁸ In the light of recent amendments, important is the possibility to challenge in the court the decision of the founders/ participants of an entity. As a part of an anti-raiding legislative package, in 2013 the law was amended to require the court to forward the decision to a legal entity and to the Registrar for making a corresponding remark, if the court has cancelled fully or partially amendments in the founding documents of the legal entity. Should there be any registration acts done after the amendments cancelled by the court, the registrar notifies the court thereof and the court makes an additional ruling to cancel the said registration acts (Article 31, Paragraph 1). The new provisions aim to restore the legal situation to the point in time before the original decision, which was challenged.

An apparently effective provision against illegal activity is the possibility for third persons in **Switzerland** to submit a written objection, based on which the registration authority shall refuse entries in the register. The freeze shall be lifted if the third person fails to show to the register within ten days that he/she has applied for an interlocutory injunction in the court or if the court has rejected such application (Article 162, Instruction on the Commercial Register).²⁷⁹

Access to the registry

In **Germany** everyone is allowed insight into the Commerce Register and the Enterprise Register and documents in the Commerce Register (Article 9, Paragraphs 1 and 6, Commercial Code).²⁸⁰ Moreover it is possible to request a printout of entries (Article 9, Paragraph 4). Upon request, the court shall issue a certification that concerning an item of a particular entry no further entries exist or that a certain entry is not done (Article 9, Paragraph 5).

In **Latvia**, everyone has the right to familiarize him/herself with entries in the commercial register and documents submitted therein. Similarly to the German rules, upon request, an official of the commercial register shall issue a certification that a certain entry in the commercial register has not been amended or a certain entry has not been made. After submitting a written request, everyone has the right to receive a notification about any application received concerning the registration file of a particular entity (Article 7, Paragraphs 1, 3 and 4, Commercial Law).

Similarly the **Norwegian** law allows everyone to acquaint him/herself with what is registered in the Enterprise register and obtain an extract from it (Article 8-1, Law on the Registration of Enterprises). Further regulations provide for several ways to obtain information – in written as a firm certificate, copies from microfilmed or scanned documents, other types of certificates and extracts as well as information provided electronically, orally over the phone or in a personal meeting (Article 12,

²⁷⁷ Law on Company registration, [*Lov om registrering av foretak*] available at <http://lovdata.no/>

²⁷⁸ The law on state registration of legal entities and individuals - entrepreneurs [*Закон Про державну реєстрацію юридичних осіб та фізичних осіб – підприємців*]. available at <http://zakon.rada.gov.ua/>

²⁷⁹ Commercial Registration Ordinance [*Handelsregisterverordnung*], available at www.admin.ch/

²⁸⁰ Commercial Code [*Handelsgesetzbuch*], available at <http://dejure.org/>

Instruction on the Registration of Enterprises).²⁸¹ In practice, entries are easily to be searched through a free online service²⁸².

Data from the Unified State Register of **Ukraine** are open and generally accessible except registration numbers of index cards of taxpayers, data about the opening and closing of accounts, imposition and removal of arrests on accounts or property (Article 20, Paragraph 1, Law on the State Registration of Legal Entities and Physical Persons – Entrepreneurs). According to the law information shall be provided as transcripts or certifications while access to the database and information in an electronic format is reserved only the Bureau of Credit Record and State organs (Article 20, Paragraph 2). If transcripts or certifications had to be requested on a case-by-case basis and were subject to charge, it would be practically impossible for a person to monitor continually any changes in information that concerns its interests. In fact online access to information about registered entities exists²⁸³.

Box 14. Good practice example – notification service of the e-Business register in Estonia²⁸⁴

Situations when bad faith acts are carried out in order to register such data about entities that do not have proper legal grounds may carry grave damaging consequences to legitimate owners and officials of the entities. Cases are known when such acts have been carried out without knowledge of the legitimate parties. Then possibilities to minimize damage (loss of assets, acts committed with stolen company identity) largely depend on how quickly the malicious act is discovered. The sooner it becomes known, the less time the perpetrator has to realize his/her intent. Therefore the notification service introduced in Estonia serves as a practical and efficient preventive tool.

“The e-Business Register has established a free-of-charge notification service providing the Board Members, Council Members and shareholders of Estonian legal persons with e-mail notice about actions in the Business Register which concern them. The notice is sent to the related persons at the moment of filing a record application. After entering the record application into the registry, the related persons can verify the entry into force of the record via the e-Business Register (Simple queries – Related companies – Login with ID card).

Related persons to whom the notice is sent:

1. Shareholders registered in the e-Business Register;
2. Council Members registered in the e-Business Register;
3. Board Members registered in the e-Business Register.

Activating the notification service

In order to receive notices, you need to activate your official e-mail address personal_ID_code@eesti.ee. After configuring the e-mail address, the notices about record amendments regarding the company will be sent to you automatically. A notice will not be sent if the amendment pertains to electronic stating of a field of activities or if a company is being entered into the Business Registry. In addition to sending notices to the personal e-mail address, the notices of record amendments are also sent to the e-mail address of the legal person as Business_Registry_code@eesti.ee and to the e-mail address entered into the e-Business Registry.”

According to the Commercial Code of Estonia entries in the commercial register are public. Everyone has the right to examine the registry cards and the business files, and to obtain copies of registry cards and documents in the business files. Registry data and files are available for examination in registration departments, notaries' offices or through a relevant website. Certified printouts from the commercial register can be obtained from registration departments or notaries' offices (Article 28, Paragraphs 1 and 2, Commercial Code).²⁸⁵

A similar service was introduced in 2013 Latvia as part of measures to prevent risks of illegal corporate raiding and other illegal acts.

²⁸¹ Regulations on the Registration of Enterprises, [*Forskrift om Registrering av Foretak*] available at <http://lovdata.no/>

²⁸² Registration of companies Database [*Kunngjøringer*] is available at w2.brreg.no/

²⁸³ On-line access is available at <http://irc.gov.ua/>

²⁸⁴ *e-Business Register*, available at www.rik.ee/

²⁸⁵ *Commercial Code*, available at www.riigiteataja.ee/

5.1.3 Conclusions

A major risk associated with public registries is submission and registration of false information. Cases are known in the Russian Federation and in other countries where private parties attempted to achieve ungrounded entries in enterprise registries or other registries of property rights based on falsified documents. In the worst cases of abuse, such falsifications have taken place with complicity of registration officials resulting in ungrounded entries and ownership certificates.

The Russian legislation contains provisions of liability of registry officials both administrative and criminal. The registration authority shall compensate for the damage caused by the denial of State registration and a number of other violations, which took place due to its fault. Criminal liability is foreseen for the falsification and destruction of documents such as single State registers, registers of holders of securities, depository accounting system, decisions of the board of directors (supervisory board) and the general assembly of shareholders (participants) of a company.

Still the falsification of electronic data in the unified State registers with the simultaneous destruction or forgery of paper documents that are the basis for changes in the e-part of the register remain a risk. Insufficient requirements of notarization and liability provisions of notaries are factors that enhance the possibility of such misuse in the Russian Federation. It is important to note that various types of misuse are possible also in the re-organisation of legal entities before the registration stage, e.g. procedural irregularities in the conduct of the general assembly of shareholders (participants) in the course of the reorganisation, absence of a quorum, signing of the minutes of the assembly by an unauthorised person, violation of the modalities for the preparation of the general assembly of shareholders (participants), etc.

The overview of several European countries shows that a strict requirement to notarize documents is among the most important measures to ensure validity of information that is entered into public registers of legal entities and the like. The reviewed country cases show that increased transparency and more efficient ways to gain the information are an important trend, which should make illicit activities more difficult.

5.2 Administrative inspections

If inappropriately designed and implemented or misused intentionally, inspections can represent a significant extra burden on businesses or even turn into a barrier against competition by particular “unwanted” companies. Inspection activity can be used also to support illegal corporate raids: “Very often the fact of performing of a raider attack is preceded by numerous inspections of regulatory agencies executed without sufficient substantiation of the check-ups. The raiders use the government agencies having the necessary authorisations in order to receive information about the company while frequent inspections are used for destabilization of the company activity.”²⁸⁶

The OECD has identified several major types of misuse of inspections:

Pirate inspections: People (officials or not) carry out inspections, which they are not legally authorised to carry out:

“In countries of Eastern Europe and the Former Soviet Union, a very frequent situation is to see inspectors, with actual authority to inspect, but visiting far more businesses, and far more often, than what they have officially been sent to do – with as a result a huge difference between the “official” number of inspections, and what businesses really receive.”

It can happen that inspections are carried out by individuals who are not authorised to carry out the inspections at all or are overstepping the mandate that they have. Pirate inspections are a problem

²⁸⁶ Shmagina, Y., Patsyuk, V. *Raider appears out of nowhere, there's no way to escape*, UL Group Association, available at <http://ulga.com.ua/>

particularly where the atmosphere of fear preclude business from questioning the authority of the inspectors.

Rivalries between agencies, overlapping regulations and levels of inspections: Inspecting authorities with authority in closely related or even overlapping fields may start rivaling one another as to which of them will be more influential, entitled to greater resources or at least just more effective. As the result, targeted business may experience double the inspection activity. The same can happen when new regulations are adopted without proper review of the existing ones or different levels of governance (e.g. national and regional) engage in controlling.

Poor self-management of inspectorates: If the results of inspection activity are not objectively assessed or are not transparent even for the management, inspection resources can be used inefficiently and – in more unfortunate situations – potential for misuse is created (intentionally or not).

Excessive inspections due to lack of risk-based targeting: It is not uncommon for inspections to attempt to cover as many businesses as possible or select those that are easier to handle rather than devote resources to areas where risks are the highest. As a result the most severe violations may remain unnoticed while other businesses are subject to wide discretion (and again – risk of abuse) by the inspectors.²⁸⁷

Giving incentives for employees to find violations: In some systems a type of misuse is programmed into operating procedures when employees are personally rewarded for finding violations. In such cases the achievement of the best protection for the public interest can be replaced with maximized repressive activity akin to harassment of businesses.

Also regarding particularly the Russian Federation, burdens posed by inspections, licensing, and registration procedures have been a well-known problem. Businesses, especially small firms, have viewed administrative officials as a threat to the security of their assets.²⁸⁸

5.2.1 The Russian Federation

It appears that problems of misuse related to administrative inspections in the Russian Federation have subdued when compared to a not so distant past. Currently administrative inspections are carried out in a large number of different sectors by different bodies in the Russian Federation.

The Russian Federation has taken steps to strengthen the protection of the rights of legal entities and entrepreneurs in administrative inspections. The Federal Law №294-FZ of December 26, 2008 “On Protection of the Rights of Legal Entities and Individual Entrepreneurs upon the Realization of the State Control (Supervision) and Municipal Control” establishes

- the organisation of inspections by supervisory bodies;
- the rights and responsibilities of supervisory authorities and their officials in conducting inspections;
- the rights and obligations of legal entities and individual entrepreneurs during the exercise of the State and municipal control as well as measures to protect their rights and legitimate interests.

The law provides a number of basic principles for the protection of rights such as the prohibition to carry out inspections by several bodies regarding the same person on its compliance with the same requirements as well as liability of control bodies and their officials for violations of the legislation in carrying out state/ municipal control. The law also limits the frequency of planned inspections (no more than once in three years; although in certain areas more often). Unplanned inspections are permitted only under certain defined conditions.

²⁸⁷ Based on: Blanc, F. *Inspection reforms: Why, How and with What Results*, pp. 21-33, available at www.oecd.org/

²⁸⁸ Gans-Morse, J. (2012). *Threats to Property Rights in Russia: From Private Coercion to State Aggression*, Post-Soviet Affairs, 2012, 28, No. 3, p.284.

Note, however, that a number of areas are not covered by this law. The law's provisions shall not apply to the criminal inquiry, preliminary investigation, the prosecutor's supervision, etc. Also certain types of administrative inspections (for example, tax and customs, banking supervision, border controls at crossing points and some others) are not covered.

In 2010, a new Article 19.6.1 was introduced in the Code of Administrative Procedures providing liability for a failure of public officials of state control (supervision) to comply with requirements of the legislation on the state control (supervision).

However, despite the rather clear provisions in the legislation of the Russian Federation, some problems do occur. For example, in the case of Marposadkabel, the largest taxpayer of the district center of Mariinsky Posad, the joint inspection of the Economic Crime Department, the Federal Tax Service, Rostekhnadzor and the Emergency Control Ministry at the end of 2012 hurt the company's work so much that its investors have been considering leaving the area. The practice of joint inspections of businesses by several offices, which originally was created to simplify the life of entrepreneurs, may lead to the opposite effect. According to the Article 9 of the law №294-FZ, authorities, which post on their websites plans of inspections for the following year, shall send them to the public prosecutor. The prosecutor decides on the conduct of joint inspections and offers to all the supervisory authorities, which are interested in a particular economic entity, to join. In practice the simultaneous execution of a number of inspections may cause a crippling burden on all departments and services of the company at the same time.

Another issue that remains problematic is the tendency of inspection bodies to apply the maximum penalties to businesses. In any legislation, there are some gradations of violations: warning, a minimum fine and a maximum fine. However, many of the monitoring bodies choose to hand the maximum penalty for the violations identified in fear of being accused of corruption if they adopted a milder penalty. Recently, however, the practice has improved, for example, the tax authorities tend to be more considerate when applying penalties.

Overall the intensity of inspections in the Russian Federation has not increased. Rather many businessmen have learned to defend their rights. For example, legal provisions can be used to postpone deadlines for some inspections in order to gain time.

5.2.2 International standards

Inspections are among the most common forms of interaction between public authorities and business. They serve vital public interests, however they also constitute a burden on enterprises and are prone to misuse. Not many international standards focus particularly on the inspection activity. A notable piece of soft standards is the OECD recommendations concerning regulatory activity. Thus **the Recommendation of the Council of the OECD on Regulatory Policy and Governance** recommends observation of such principles as:

“2. Adhere to principles of open government, including transparency and participation in the regulatory process to ensure that regulation serves the public interest and is informed by the legitimate needs of those interested in and affected by regulation. This includes providing meaningful opportunities (including online) for the public to contribute to the process of preparing draft regulatory proposals and to the quality of the supporting analysis. Governments should ensure that regulations are comprehensible and clear and that parties can easily understand their rights and obligations.

3. Establish mechanisms and institutions to actively provide oversight of regulatory policy procedures and goals, support and implement regulatory policy, and thereby foster regulatory quality.

7. *Develop a consistent policy covering the role and functions of regulatory agencies in order to provide greater confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence.*

8. *Ensure the effectiveness of systems for the review of the legality and procedural fairness of regulations and of decisions made by bodies empowered to issue regulatory sanctions. Ensure that citizens and businesses have access to these systems of review at reasonable cost and receive decisions in a timely manner.*

9. *As appropriate apply risk assessment, risk management, and risk communication strategies to the design and implementation of regulations to ensure that regulation is targeted and effective. Regulators should assess how regulations will be given effect and should design responsive implementation and enforcement strategies.*

10. *Where appropriate promote regulatory coherence through co-ordination mechanisms between the supranational, the national and sub-national levels of government [..].*²⁸⁹

From the recommendation, one can infer essential keywords such as transparency, clarity, oversight, consistency, objectivity and impartiality, system of review, risk-based approach, and coordination. Although most of these principles do not address the possible misuse of public authority head-on, a system based on them would likely minimize opportunities for wrongdoing.

On a more detailed level, it is recommended, for example, to “make sure that policies and practices for inspections and enforcement respect the legitimate rights of those subject to the enforcement, are designed to maximize the net public benefits through compliance and enforcement and avoid unnecessary burdens on those subject to inspections.” It is recommended to consider risk-based approaches in regulatory compliance strategies to increase the achievement of compliance goals while minimizing costs on business due to compliance and enforcement procedures. Of key importance here is the efficiency to be achieved through the least burdensome compliance activities applied in such places and way that would maximize the achievement of policy goals.

Worth noting is also the **Entrepreneurship Policy Framework and Implementation Guidance of the United Nations Conference on Trade and Development**, which addresses in particular the optimization of the regulatory environment with such policy objectives in mind as, for example, minimizing regulatory hurdles for business start-ups where appropriate and building entrepreneurs’ confidence in the regulatory environment (the latter including such policy options as good governance, easier and faster contract enforcement, alternative conflict resolution mechanisms, guaranteed property protection, reduced bankruptcy stigma and facilitated re-starts).²⁹⁰

5.2.3 Council of Europe member states

Consolidated v. decentralized inspection activity

In some countries, where the misuse of inspection authority against particular market players, carries sporadic and sectoral character, consolidation of various types of inspection in a single body, which then ensures a high level of professionalism and integrity, can be a solution. Such consolidation of inspection authorities has been used to reduce overlaps and duplications of inspections, administrative burden on enterprises and, not least, also state expenditure for the activity.²⁹¹ An example of such institutional consolidation is the State Inspectorate of **Croatia** with the authority to carry out inspections in the areas of trade and services, labour and safety at work, electric power, mining, pressure equipment, accounting, collection and payments of tourism fees, catering and tourism

²⁸⁹ OECD (2012) [The Recommendation of the Council of the OECD on Regulatory Policy and Governance](http://www.oecd.org/), available at www.oecd.org/

²⁹⁰ UNCTAD. [Entrepreneurship policy framework and implementation guidance](http://unctad.org/), available at <http://unctad.org/>

²⁹¹ Blanc, F. [Inspection reforms: Why, How and with What Results](http://www.oecd.org/), p.64, available at www.oecd.org/

services as well as other areas stipulated by law (Section 2, Paragraphs 1 and 2, Law on the State Inspectorate).²⁹²

Another approach is to consolidate the legal framework of inspection activities even when they are not organisationally consolidated. This is the approach embodied in the **Slovenian** Law on Inspections. According to the law, by default, inspection services function within inspectorates, which are bodies within ministries (Section 8, Law on Inspections).²⁹³ However, for the purpose of coordination, the law also establishes a permanent inter-ministerial Inspection Council headed by the minister responsible for administration or by a person authorised by him/her (Section 11). Coordination may take place even on a voluntary basis as in the case of the Inspection Council of **the Netherlands**.²⁹⁴

Meanwhile decentralized models for the organisation inspection activities function elsewhere. More than a decade ago, analysis on **Norway** identified 39 supervisory bodies in 2002.²⁹⁵ The analysis noted the existence of a number of bodies that “have significant overlapping responsibilities. This is particularly true for safety issues. Private companies are facing up to 9 different *tilsyn* in charge of various aspects related to safety at work. This creates an unnecessary administrative burden and results in complexity as businesses have to comply simultaneously with different regulations and requirements.”²⁹⁶ The decentralized model of Norway remains in place. However, it has been the government’s position that authorities with inspection functions shall coordinate the activities so as to cause less of burden to those subject to the inspections.²⁹⁷ A decentralized model is found also in **Ukraine** where the government website lists twelve state inspectorates.²⁹⁸

Risk-based approach to inspections

An inherent aspect of inspections that are intended for harassment of particular enterprises is the discretionary character of decisions to start inspections and the scope of such inspections. Since no regime of inspections could possibly aim at controlling all enterprises on all aspects of their activities, there is always a need to make choices as to whom to inspect, on what issues and how broadly. A widely recognised basis for the choice is the assessment of risk, which can be understood as the effect (of a certain violation) combined with its probability.²⁹⁹ Obviously it cannot be taken for granted that the expected effects shall be gravest in all those areas where the expected number of violations is greatest (rather there may be particular areas where many violations may have just relatively mild effects).

An example of risk-based control policy embedded in the European Union legislation is the area of feed and food law, animal health and welfare rules. Member states are obliged to ensure that official controls are carried out regularly, on a risk basis and with appropriate frequency, so as to achieve the objectives of the regulation (Article 3, Paragraph 1, Regulation (EC) No 882/2004).³⁰⁰

In line with the European regulation, for controls in the areas of food, wine, feed and tobacco, **Germany** establishes the rule that, for the realization of official control, the enterprises to be controlled shall be first ranked into risk categories/ risk types and the frequency of control for these enterprises shall be established (Section 6, Paragraph 1, General Administrative Instruction on the Principles for the Implementation of Official Supervision of Compliance with Food, Wine, Feed and

²⁹² *Inspection Act [Zakon o državnom inspektoratu]*, available at www.zakon.hr/

²⁹³ *Inspection Act [Zakon o inšpekcijskem nadzoru]*, available at <http://zakonodaja.gov.si/>

²⁹⁴ *Inspection Act [Inspectieraad]*, available at www.inspectieloket.nl/

²⁹⁵ OECD (2003), *Regulatory reform in Norway*, p.6, available at www.oecd.org/

²⁹⁶ OECD (2003), *Regulatory reform in Norway*, p.24, available at www.oecd.org/

²⁹⁷ St.meld. nr. 19 (2008-2009). *Management for democracy and community [Ei forvaltning for demokrati og fellesskap]*, available at www.regjeringen.no

²⁹⁸ *Inspection Act [Ишчекүюу]*, available at www.kmu.gov.ua/

²⁹⁹ *Air Traffic Inspection, Risk-based analysis [Luftfartstilsynet. Risikobasert tilsyn]* available at www.iaa.no/

³⁰⁰ *Regulation (ec) no 882/2004 of the European Parliament and of the Council of 29 April 2004 on official controls performed to ensure the verification of compliance with feed and food law, animal health and animal welfare rules*, available at <http://eur-lex.europa.eu/>

Tobacco Legislative Regulations).³⁰¹ The ranking for each enterprise shall be documented and updated (Section 6, Paragraph 2). Within the frame of the official control, the entrepreneur is to be informed about the result of the ranking (Section 7, Paragraph 6). The German regulation also defines the formation of the multi-year national control plan and the federal supervision plan (Sections 10 and 11).

Risk-based inspections are widely used also in **Norway** where planning of inspections shall include supervision of the area of responsibility as well as the analysis of risks and materiality.³⁰² Among other tools, Norwegian authorities use the ranking of businesses into classes of supervision. For example, the Trondheim Commune classified businesses for health and environment risks into five categories:

- A – businesses, for which inspection frequency is determined in the law/regulation;
- B1 – businesses with considerable risk (annual inspections);
- B2 – middle risk (inspection every second year);
- B3/B4 – middle to low risk (inspection every third or fourth year);
- C – negligible risk (inspection upon complaint).³⁰³

Protections

Inspections may involve considerable intrusion into the rights of persons whose activity is under scrutiny. Moreover inspectors may have such rights of access to documents and premises, which provide sometimes even greater discretion than available for the law enforcement within criminal investigations. This sub-chapter will look into a few examples of protections.

The **Slovenian** Law on Inspections establishes principles of inspections: independence, protection of the public interest and private interests, publicity (on the basis of and within the limits of the authorisation of the head, inspectors shall inform the public of their findings and measures taken if this is necessary to protect the rights of legal or natural persons and if this is necessary to ensure respect for the legal order or its provisions) and, what is especially important, the principle of proportionality:

- Inspectors shall perform their duties in such a manner that, in exercising their powers, they shall interfere with the operation of legal and natural persons only to the extent necessary to ensure an effective inspection;
- In the selection of measures, inspectors, taking account of the gravity of the violation, shall impose a measure more favourable to the person liable if this achieves the purpose of the regulation;
- In setting the time limit for the elimination of irregularities, an inspector shall take into account the gravity of the violation, its consequences for the public interest and the circumstances determining the time period within which the natural or legal person supervised by the inspector (hereinafter: the person liable) can, by acting with due care, eliminate irregularities (Sections 4-7).

The Slovenian law attempts to strike a balance between the right of the inspector to enter businesses and premises not belonging to the liable person and the right of such persons to refuse the entry. Four conditions are set in the law. Such persons may refuse to allow an inspection:

- if the premises concerned are residential premises and an inspector does not have the appropriate court decision;

³⁰¹ *General Administrative Regulation on principles for official verification of compliance with food law, wine law, feed law, tobacco legislation* [*Allgemeine Verwaltungsvorschrift über Grundsätze zur Durchführung der amtlichen Überwachung der Einhaltung lebensmittelrechtlicher, weinrechtlicher, futtermittelrechtlicher und tabakrechtlicher Vorschriften*], available at www.verwaltungsvorschriften-im-internet.de/

³⁰² Riksrevisjonen (2014) *Investigation of state supervision activities* [*Riksrevisjonen Riksrevisjonens undersøkelse av statlig tilsynsvirksomhet*], p.26, available at www.riksrevisjonen.no/

³⁰³ Trondheim City Council (2008) *Guidelines for risk-based supervision in environmental health and pollution* [*Retningslinjer for risikobasert tilsyn innen miljørettet helsevern og forurensning*], pp. 5-6, available at <http://filer.fmh.no/>

- if the inspection might cause them severe embarrassment and considerable property damage or lead to criminal prosecution;
- if, by allowing the inspection, they would violate their duty or right to protect business, professional, artistic or scientific secrecy; or
- in any other case where, by allowing the inspection, they would violate their duty to protect the secrecy of information they have acquired as a priest, lawyer, doctor or in pursuing any other profession or activity involving the same duty (Section 21).

In **Norway**, the legitimacy of the inspection activity and general protection of legitimate interests of involved parties is secured through traditions and legal guarantees for extensive communication. According to the law, party, which has not already expressed itself in a case through an application or in another way, shall be notified before a decision is made and given opportunity to express itself within a specified time limit. Advance notice may be omitted under specific circumstances, e.g. it would involve the risk that it would not be possible to implement the decision (Section 16, Administration Law³⁰⁴). Of relevance for the development of regulatory approaches is the requirement that public and private institutions and organisations in occupations, trades or interest groups, to which regulations will apply or already apply, if their interests are particularly affected, shall be given a possibility to express themselves before the regulation is issued, amended or repealed. Still, for example, if it could impede the implementation of the regulation or weaken its effectiveness, the notification can be omitted (Section 37).

An example of a detailed protection is the **Danish** Law on Legal Protection upon the Use by Administration of Coercive Powers and Duties of Disclosure. The law governs situations when, outside the criminal procedure, administrative authorities carry out search of residence, other premises, examine or seize correspondence, other documents or items, violate the secrecy of correspondence or examine people and when legislation requires disclosure of information to the authorities (Section 1, Paragraphs 1-3).³⁰⁵

For the search of residence and search or seizure of letters or other documents, the law defines general rules of procedure such as the requirement that coercive powers shall be used only when less intrusive means are not sufficient and the intervention is proportionate to its purpose (Section 2). The general rule is to notify the concerned party at least 14 days before the implementation of a coercive intervention. The party has the right to object and the overruling of the objection must be grounded in written. However, the notification requirement is subject to exceptions defined in the law, which then carry specific requirements and procedures for the substantiation of the derogation (Section 5). Forced intrusion must be carried out as gently as circumstances permit, including as far as possible without causing destruction or damage and without the interference due to the time of the making or the way in which it takes place, giving rise to undue attention (Section 7).

Upon suspicion of a criminal offence, coercive intervention with the purpose to obtain information about the offence can take place only according to the criminal procedure. It applies also in cases when the intervention aims against a person other than the one who is suspected of the offence (Section 9, Paragraphs 1 and 3). The law also contains provisions to uphold the right against self-incrimination (Section 10).

Public accountability of inspection institutions

Inspection bodies are typically subordinate to the executive branch of government and hence do not possess strong independence guarantees. The **Croatian** case is interesting in that the inspection body is elevated to be subordinated directly to the government rather than ministries. In Croatia the government appoints and dismisses the Chief Inspector. The government also appoints and dismisses

³⁰⁴ *Public Administration Act*, [*Lov om behandlingsmåten i forvaltningssaker (forvaltningsloven)*], available at <http://lovdata.no/>

³⁰⁵ *Procedural Law* [*Retssikkerhedsloven (tvangsindgreb m.v.)*], available at www.foxylex.dk/

the deputy Chief Inspector and assistants of the Chief Inspector upon proposal of the Chief Inspector (Section 9, Paragraphs 1-3, Law on the State Inspectorate).

Box 15. Good practice examples – information and guidance³⁰⁶

To prevent possibilities of misuse, it is essential that businesses know in principle what inspections can be expected, what they will do and what the limits of their mandate are. This does not mean that surprise inspections should not be possible but the principal possibility of a certain type of inspection should not be a secret.

An example of an innovative tool is the Company Dossier, which was introduced in the **Netherlands** in 2011. In brief, a company dossier is a web tool where a company can post information, including such information as is relevant for the company's compliance with existing regulations, and then decide which government authorities shall have access to the information. Particular details of the arrangement are agreed between the authorities and relevant sector associations. On-site inspections, when necessary, can make use of preliminary review of the information that has been already posted by the company in question. Associations of four branches (catering, recreations, rubber and plastics as well as vehicle dismantling enterprises) and 51 authorities have joined the system as of beginning 2014.³⁰⁷

The Investment Climate Advisory Services of the World Bank Group have assisted the government of **Azerbaijan** in tackling inspections reform through initiatives to not only improve the systems and processes for inspections, but also create forums for knowledge sharing and exchange among practitioners. In May 2011 Azerbaijan launched the Electronic Registry of Inspections. The centralized e-Registry sets clear procedures for both inspectors and businesses, and allows for process traceability, post-inspection evaluation, and accurate data collection. Entrepreneurs will now have better access to information about planned inspections and can request clearance notification on the validity of an upcoming inspection. The e-Registry³⁰⁸ is expected to improve the effectiveness of business inspections and help strengthen compliance with government regulations.

5.2.4 Conclusions

At least in the past, misuse of the power of administrative inspections used to be a major burden on the business in the Russian Federation. Over time legal protections for legal entities and individual entrepreneurs have been strengthened and the practice seems to have improved. The Russian Federation has a legal framework for the protection of rights of legal entities and individual entrepreneurs in the process of supervision activities by public bodies as well as procedures for rational planning of inspection authorities.

However, the nature of inspections inevitably involves certain burdens on and intrusion into activities of businesses. Even in countries with well-developed and generally law-abiding public administration the minimization of unnecessary costs imposed by inspections remain challenging.

A review of the international experience shows that a key risk of abuse in the area of administrative inspections is discretion regarding the choice of organisations/ enterprises for inspection. In countries where there is weak or no system of risk-based targeting, it is difficult to limit the burden caused by the inspections on such areas and enterprises where non-compliance is unlikely to cause major harm to the public interest. Other generally known problems in the international practice are overlapping competencies of various inspection bodies (hence also overlapping inspection activities), lacking assessment of the effectiveness of inspection activities, and overzealous controls in areas where finding of violations is easier (instead of targeting the more dangerous irregularities).

³⁰⁶ International Finance Corporation. *Azerbaijan Ramps Up Inspections Reform with World Bank Group Support*, available at www.ifc.org/

³⁰⁷ *Company File [Ondernemingsdossier]*, available at www.ondernemingsdossier.nl/

³⁰⁸ The *e-Registry* is available at www.yoxlama.gov.az/

In addition to strict legal remedies against infringement of rights and risk-based targeting, the review of selected European countries shows certain centralization of inspection activities and innovative forms of communication with the enterprises as the approaches of choice in some cases.

5.3 Misuse in the area of competition law

Competition legislation is a cornerstone for ensuring sound functioning of the market economy. Its correct application can ensure fair rules of the game for all market operators while ill-designed legal provisions and/or their faulty implementation can seriously damage or even eliminate competition in certain sectors of the economy. Four types of misuse or otherwise faulty practices of anti-monopoly authorities are identified below:

- **Lack of clarity of the law**, e.g. regarding the qualification of violations;
- **Poorly grounded decisions**: The antimonopoly authority may have failed to investigate the market situation adequately (in the Russian Federation, in the case No. A21-2808/2009 of December 29, 2009, a decision of the competition authority was recognised as invalid *inter alia* because the authority had not identified all the participants of the market that could impact the competitive environment) or gather sufficient evidence. Its decisions may contain insufficient amount of analytic content making it difficult to use the decisions as guidance for future compliance with the competition law or obscuring the determination of penalties;³⁰⁹
- **Political interference**: For example, the government may have the authority, due to ostensibly public interest benefits, to overturn decisions to refuse permission of concentrations and concerted actions.³¹⁰ In fact, there can be legitimate grounds for the sovereign government to exercise such authority but it should be guided by impartial consideration of the public interest;
- **Misuse in control and investigative proceedings**: Competition authorities typically have intrusive powers to obtain information, search premises and seize various materials. If the legal requirements concerning judicial warrants for actions such as search of premises and possibilities to complain are too limited (or not applied in practice adequately), there are risks of abuse against particular business entities. Risks of abuse exist also when competition authorities do not protect confidential information adequately.

Two broad further areas represent high-risk of misuse against competition – the public procurement and state-owned enterprises. However, these areas are too complex to be covered within the limits of this study. For detailed analysis of risks in these areas, it is recommended to consult, for example, the resources of the OECD.³¹¹

5.3.1 The Russian Federation

The Federal Antimonopoly Service (FAS) carries out functions of the antimonopoly authority. The FAS is the authorised federal body of executive power responsible for the adoption of regulatory legal acts, control and supervision over observance of the legislation in the sphere of competition in product markets, competition in the market of financial services, natural monopolies, advertising (as far as established by the legislation on the powers of the antimonopoly authority). The federal system of the antimonopoly authorities of Russia consists of the FAS and territorial bodies (departments).

Liability for violation of the antitrust laws is governed by Article 7 of the Federal Law №135-FZ of July 26, 2006 (hereinafter – the law on the protection of competition). For violation of the antimonopoly legislation, officials of state bodies, local self-government bodies, officials of other agencies or organisations carrying out these functions, as well as officials of the state non-budgetary

³⁰⁹ For information on Ukraine see: OECD (2008) *Competition Law and Policy in Ukraine*, pp. 53, 54 , available at www.oecd.org/

³¹⁰ For information on Ukraine see: OECD (2008) *Competition Law and Policy in Ukraine*, p. 47 , available at www.oecd.org/

³¹¹ See: OECD. *Integrity in public procurement*, available at www.oecd.org/

OECD (2009) *State Owned Enterprises and the Principle of Competitive Neutrality*, available at www.oecd.org/

funds, commercial and non-commercial organisations and their officials, natural persons, including individual entrepreneurs, bear responsibility stipulated by the legislation of the Russian Federation.

The following are violations of antitrust laws:

- abuse of a dominant position;
- unfair competition;
- restriction of competition, etc.

The most frequent violations of the antitrust laws are:

- violation of the rules of pricing;
- failure to submit applications, information to the antimonopoly authority/ to the body regulating natural monopolies;
- failure to comply within the due time with the legal requirements (regulations) of a body (official) exercising the state supervision (control);
- failure to take measures to eliminate the causes and conditions conducive to an administrative offence;
- violation of the legislation on advertising, etc.

In disputes, qualified by the antimonopoly authority as an abuse of a dominant position of market power, the violation of price formation stands out. For a violation of price formation, liability under Article 14.6 (part 2) and Article 14.31 of the Code of Administrative Offences is possible. However, the penalties for the same violation are different:

- According to part 2 of Article 14.6 of the Code of Administrative Offences, for “other” violation of the established order of pricing, the administrative fine for legal entities is in the amount of one hundred thousand roubles;
- Article 14.31 of the Code of Administrative Offences for the abuse of dominant position (including violation of the order of pricing) provides for fines for legal persons, usually between one hundredth and fifteen hundredths of the amount of revenue the offender gained from the realization of goods (works, services).

The variation in the amounts of fines for violations of the order of pricing is huge. Article 10 of the law on protection of competition has one defining element concerning the liable person, i.e. the Article 14.31 of the Code of Administrative Offences may be applied to an entity that occupies a dominant position. The judicial practice suggests that, if the offender has the dominant position, then the Article 14.31 should be applied. If it does not have a dominant position, the offence can be qualified on the basis specified in Article 14.6.

Currently, when considering such cases, the antimonopoly authority at its discretion applies the legal qualification of the violation committed by natural monopoly entities. This legal uncertainty raises a lot of questions. It turns out that for the antitrust authority, and later to the court, it does not matter that the contracting party did not suffer losses because the service was rendered at an economically sound cost.

Therefore, the root cause of violations of the law is often incomplete or ambiguous interpretation of the legal provisions that does not ensure the proper regulation of legal relations. The application of the rules on the violation of the order of pricing by the antimonopoly authority is arbitrary and formalistic. The law should recognise a violation of the order of pricing as the abuse of dominant position only when such actions (failure to act) have caused damage.

Box 16. Examples of litigation with government authorities regarding violations of antitrust laws

In the procurement-related case No.50-79/2010 of May 13, 2010, the antimonopoly authority had acted in excess of authority because the termination of the trading and the cancellation of the

protocols of the commission meetings on the results of the competition mean the recognition of the tender invalid. However, this body only has the power to appeal to the Court with such lawsuit. The Court's conclusion was correct that the legislation established a different procedure for the antimonopoly authority to recognise the trading invalid.

In the case No.A21-2808/2009 of December 29, 2009, the decision of the antimonopoly authority on the abuse of a dominant position in the market of granting the use of space in the cable duct shall be recognised as invalid if the antimonopoly authority has not identified all of the participants of the disputed goods market that could have an impact on the competitive environment. Moreover there was no reason to limit the relevant market to the services of providing space exclusively in the cable duct.

In the case No.A14-19818/2009, upon recognizing the illegality of the decision of the antimonopoly authority, which found the applicants to be in conflict with Article 16 of the law on protection of competition in the part of concerted action, the Court did not find indications of a legally significant agreement. The antimonopoly authority did not provide relevant evidence.

In the case No.A14-2020/2010, the Court invalidated the decision of the antimonopoly authority, according to which actions of a group of persons to obstruct access to services market were recognised as the abuse of the dominant position, since these organisations carried out economic activity and occupied dominant positions in different product markets.

5.3.2 International standards

Competition is an area with an extensive body of international rules. In particular, in the Europe Union one can mention Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU) aimed against respectively cartel agreements and abuse of dominant position. However, international standards on competition as such are not directly relevant for this study, which focuses on the misuse of public authority and prevention thereof. Suffice it to mention that the Article 101 of the TFEU contains an exception applicable under certain conditions to otherwise prohibited agreements if they contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit. Such provision embodies a lenient approach to agreements, which serve a certain legitimate public interest.

Of relevance for the topic of this study are the general international standards for the protection of fundamental rights, particularly within procedures of administrative inquiry. However, these, as a rule, are not specific for the area of competition policies.

A piece of specific recommendatory standard that relates to the issue of fairness and transparency in the implementation of competition policies is **the Recommendation of the OECD Council on Merger Review**.³¹² The document advises OECD members to ensure:

- that the rules, policies, practices and procedures involved in the merger review process are transparent;
- timely notice to merging parties about competitive concerns raised with a meaningful opportunity to respond;
- that merging parties have the right to seek review by a separate adjudicative body of adverse decisions;
- the opportunity to consult with the competition authorities at key stages of the review process;
- rights of expression of views of third parties during the review process;
- protection for business secrets and other confidential information.

³¹² OECD (2005) *Recommendation of the Council on Merger Review*, available at <http://acts.oecd.org/>

5.3.3 Council of Europe member states

This part of the chapter will look into the situation of five other member states of the Council of Europe – Germany, Latvia, Norway, the United Kingdom, and Ukraine. Each country is examined separately using the following format:

Anti-monopoly services: Here the relevant authorities will be named as defined in the legislation of the respective countries.

Information to parties: What specific rights do parties have to obtain information during a review / investigation procedure (notwithstanding general freedom of information provisions)? Subject to the availability of information, how are the authorities required to implement provision of information?

Intrusive powers of anti-monopoly services: Particularly what rights the authorities have to request documents and other information, enter and search premises, seize materials? What are the possibilities of appellate review ensured during the proceedings?

Possibilities to challenge final decisions: What are the possibilities to challenge final decisions of competition authorities?

Germany

Anti-monopoly services are the Federal Cartel Authority, the Federal Ministry for Economy and Technology (since 2013 – for Economy and Energy) and the respective supreme land authorities (Article 48, Paragraph 1, Law against Restraints of Competition).³¹³

Information to parties: The Law against Restraints of Competition provides the essential procedures for the information exchange of the parties of a case. In administrative procedures before cartel authorities, participants have the right to comment (Article 56, Paragraph 1) and the authorities may give such an opportunity also to representatives of the affected business circles (Article 56, Paragraph 2). Moreover a possibility exists to hold a public, oral deliberation upon request or on the authority's own initiative (Article 56, Paragraph 3).

The concerned persons shall be informed without delay about seizure of objects (Article 58, Paragraph 1). Reasoned decisions of cartel authorities shall be provided to the participants of the case with advice as to the available legal remedies; they shall also be informed if the procedure is closed without a decision (Article 61). Certain decision shall be published in the official gazette (Article 62).

In administrative offence procedures the general rules of the Administrative Offences Law also apply, which govern *inter alia* such matters as the right of insight into the files.

Intrusive powers of anti-monopoly services: In administrative procedures, a cartel authority may conduct any investigations and collect any evidence required (Article 57, Paragraph 1). The cartel authority may seize objects which may be of importance as evidence in the investigation. Within three days of the seizure, the cartel authority shall seek judicial confirmation by the local court in whose district the seizure took place, if neither the person affected nor any relative of legal age was present at the seizure or if the person affected or, in his absence, a relative of legal age explicitly objected to the seizure. The affected person may at any time request judicial review of the seizure (Article 58, Paragraphs 1-3). Search can be carried out only based on the authorisation of a judge, which can be appealed against in accordance with criminal procedures (in urgency and during business hours, search can be carried out also without judge's authorisation) (Article 59, Paragraph 4).

In administrative offence procedures the powers will be determined also by the Administrative Offences Law.

³¹³ Act against Restraints of Competition [*Gesetz gegen Wettbewerbsbeschränkungen*], available at <http://dejure.org/>

Possibilities to challenge final decisions: In merger control proceedings, companies may appeal against a decision by the Federal Cartel Authority on a factual and legal basis, this being a possibility of a full factual and legal review of the decision (Article 70). The court itself may investigate all the facts in full.

In the case of administrative offence proceedings, the Federal Cartel Authority reviews the complaint first. If the decision is not changed, it can again be appealed in the court regard to the factual and legal issues.³¹⁴

Latvia

Anti-monopoly service is the Competition Council, an administrative agency under the supervision of the Ministry of Economy. It consists of a three-member council supported by an executive directorate (Article 4, Paragraph 1; Article 5, Paragraph 1, Competition Law).³¹⁵

Information to parties: The Competition Law contains few specific provisions concerning information of the parties of a case. In particular, a market participant or other person in relation to whom search is carried out shall be informed about their rights upon commencing of the search. They have the right to be present during the search, express comments and requests, and familiarize themselves with the protocol of the proceedings and the attached documents (Article 9.³). Otherwise a strict requirement to inform the suspected offender of a commenced review case is not provided (the Article of the Competition Law that is probably violated shall be communicated to the suspect if the Competition Council requests information from the suspect (Article 26, Paragraph 4)). The Competition Council shall provide information in written once it has obtained the information necessary for a decision. Then the parties may look into the case; provide comments and additional information (Article 26, Paragraphs 6 and 7).

Intrusive powers of anti-monopoly services: The executive directorate of the Competition Council is entitled, among other things, to request and receive from any person any information necessary to perform its tasks (including information containing commercial secret) as well as written or oral explanations, withdraw property and documents of a market participant or an association of market participants (or other persons under stipulated conditions) which may be of importance in the case. On the basis of a judicial warrant, without prior notice and in the presence of police, it may enter the non-residential premises, means of transport, apartments, etc. and carry out forcible search, prohibit the persons who are present at the site under inspection from leaving the site without permission, temporarily seal premises, means of transport, structures and other objects and the storage facilities therein, in order to ensure the preservation of evidence, etc. (Article 9, Paragraph 5). The State Police shall provide assistance to the performance of the investigatory activities (Article 9, Paragraph 9).

The party concerned may submit a complaint against the judicial warrant to the president of the court, who shall review the complaint within 10 days in presence of a representative of the complainant (Article 9.¹, Paragraph 4).

Possibilities to challenge final decisions: Decisions of the Competition Council, except for decisions regarding the initiation of a case and the extension of the time period for the taking of a decision, may be appealed by a market participant to the regional administrative court (Article 8, Paragraph 2).

Norway

Anti-monopoly services: According to the law the competition bodies are the King, the ministry and the Competition Authority (Article 8, Competition Law).³¹⁶

³¹⁴ OECD (2012) [Institutional and procedural aspects of the relationship between competition authorities and courts, and update on developments in procedural fairness and transparency](#), p.47, available at www.oecd.org/

³¹⁵ *Competition Law [Konkurrenseis lov]*, available at <http://likumi.lv/>

³¹⁶ *Competition Law [Lov om konkurranse mellom foretak og kontroll med foretakssammenslutninger (konkurranseloven)]*, available at <http://lovdata.no/>

Information to parties: The Access to Information Law does not apply to several categories of cases and decisions of the Competition Authority before the case is completed. Entities of persons that are investigated by the Competition Authority shall, upon demand, be granted access to documents of the case as long as it can happen without damage or danger for the investigation or third persons (Article 26).

Intrusive powers of anti-monopoly services: The competition bodies are entitled to require all types of information and carriers of such information needed for handling of their cases or to fulfil Norway's treaty obligations in relation to a foreign state or international organisation (Article 24). In search for evidence, when there are reasonable grounds to suspect a violation, the Competition Authority may demand access to premises and, when there are special reasons to think that evidence is held there, also residences. It may take with it things that are of relevance as evidence for further assessment as well as seal premises, accounts and documents as long as necessary during an investigation. For access to securing evidence, the Competition Authority must obtain a court warrant in advance. The targeted person shall not be warned of such request and warrant and appeal against it does not have a suspensive effect. The Competition Authority may demand the presence of the police. If there is no time to wait for a court warrant, the Competition Authority may demand that the police secure the area where the evidence is held until the warrant is obtained (Article 25).

Possibilities to challenge final decisions: The ministry may reverse a decision of the Competition Authority even if there is no complaint (Article 8). There have been concerns that such procedure of review is lacking independence. Fines cannot be appealed against other than in the court.

The United Kingdom

Anti-monopoly services: Until 2014, the two relevant bodies were the Office of Fair Trading and the Competition Commission. The Office of Fair Trading was principally responsible for the application and enforcement of the competition law. Investigation of mergers and markets was carried out also by the Competition Commission (often upon notice from the Office of Fair Trading). The Competition and Markets Authority became fully operational in 2014 and combines many functions of both of the above agencies. However, the rest of this sub-chapter will still cover the situation as before 2014.

Information to parties: Upon opening a formal investigation, the Office of Fair Trading of the United Kingdom sends the businesses under investigation a case initiation letter "setting out brief details of the conduct that [it is] looking into, the relevant legislation, the case-specific timetable, and key contact details for the case such as the team Leader, project Director and SRO".³¹⁷ The office also commits to generally provide case updates to companies under investigation and formal complainants by telephone or in writing. The office holds "state of play" meetings with parties under investigation, particularly, when the case has been formally opened, before a decision is taken on whether to issue a statement of objections, after representation on the statement of objections have been received, and on other occasions.³¹⁸

Box 17. Good practice example – merger assessment guidelines of the United Kingdom

Possibilities of the misuse of authority and unjustified discretion reduce when the concerned parties know the principles that underlie policies and know what procedures the authorities follow within the legal framework, which can be sometimes quite broad. An example of this type is the Merger Assessment Guidelines published by the Competition Commission and the Office of Fair Trading. Importantly, the publication of such guidelines is mandated by law requiring that the Office of Fair Trading and the Competition Commission prepare and publish general advice and information about the making of references by the Office of Fair Trading to the Commission when a relevant merger situation has been created and the creation of that situation has resulted or may be expected to result in a substantial lessening of competition as well as about the consideration of the references and the

³¹⁷ Office of Fair Trading (2012) *A guide to the OFT's investigation procedures in competition cases*, p. 23 , available at www.offt.gov.uk/

³¹⁸ Office of Fair Trading (2012) *A guide to the OFT's investigation procedures in competition cases*, pp. 47-48, available at www.offt.gov.uk/

way relevant customer benefits may affect the taking of enforcement actions in relation to such references (Article 22, Paragraph 1 and Article 106, Paragraphs 1 and 3, the Enterprise Act 2002³¹⁹). The explanatory note concerning the guidance specifies the following:

“This section requires the OFT and the CC to publish advice and information about certain of their key tasks in the merger scrutiny process. The OFT will be required to explain how it will apply its duty to make references. The CC will have to explain how it will consider references. This information and advice will include explanations of how the OFT and CC will apply the substantive tests in the new regime, including, in particular, the application of the substantial lessening of competition test, and the circumstances and manner in which relevant customer benefits will be taken into account when the OFT considers references and when the CC is considering possible remedies. The OFT and the CC will be required to consult each other (and others they consider appropriate) in preparing their respective advice and information. It is intended that the information and advice will increase clarity for business about how the new regime works.”

Intrusive powers of anti-monopoly services: The Office of Fair Trading may send written information requests. The request “will tell the recipient what the investigation is about, specify or describe the documents and/or information”³²⁰ required, etc. In some cases, concerning large information requests, advance notices of the requests may be issued.

Powers to enter premises depend on whether business premises or domestic premises are to be inspected, i.e. under certain circumstances business premises may be entered without a warrant (but not domestic premises). According to the published guide, when an inspection without a warrant is taking place, the officers may require any person to:

- produce any document that may be relevant to the investigation;
- provide an explanation of any document produced;
- or tell where a document can be found if the officers consider it relevant to the investigation.

It may also be required to produce any relevant information electronically stored in a form that can be read and taken away. Steps may be taken to preserve documents or prevent interference with them.

A warrant allows the officers to use force in order to enter premises (though not against a person) and search the premises. They may take away original documents that appear to be covered by the warrant and documents or copies thereof to determine whether they are relevant to the investigation as well as copies of computer hard drives, etc.

It is not allowed to require the production of privileged communications (e.g. between a professional legal adviser and their client) and violate the privilege against self-incrimination.

Possibilities to challenge final decisions: The Competition Appeal Tribunal hears appeals on the merits in respect of decisions made under the Competition Act 1998 by *inter alia* the Office of Fair Trading, actions for damages and other monetary claims under the Competition Act 1998 as well as review decisions made by the Secretary of State, the Office of Fair Trade and the Competition Commission in respect of merger and market references or possible references under the Enterprise Act 2002.³²¹

³¹⁹ [Enterprise Act 2002](http://www.legislation.gov.uk/), available at www.legislation.gov.uk/

³²⁰ Here and further information on the powers of the Office of Fair Trading taken from: Office of Fair Trading (2012)

[A guide to the OFT's investigation procedures in competition cases](http://www.oft.gov.uk/), available at www.oft.gov.uk/

³²¹ [About the Competition Appeal Tribunal](http://www.catribunal.org.uk/), available at www.catribunal.org.uk/

Ukraine

Anti-monopoly services: The Anti-monopoly Committee is responsible for the implementation of the Law on the Protection of Economic Competition and the Law on Protection against Unfair Competition (Article 5, Law on the Anti-monopoly Committee of Ukraine).³²²

Information to parties: The Law on Protection of Economic Competition foresees that a resolution to start the review of a case is sent to the defendant within three working days since its adoption. Persons who participate in a case have the right to familiarize themselves with materials of the case (except confidential information or information that, if disclosed, can harm other persons who participate in the case or hamper further investigation of the case), obtain copies of decisions (again subject to confidentiality restrictions) and appeal decisions in the procedure set by law (Article 40, Paragraph 1, Law on Protection of Economic Competition).³²³

Intrusive powers of anti-monopoly services: In principle the Anti-monopoly Committee has broad authority in cases and according to procedure established by law to carry out inspections of service premises and means of transport of economic operators – legal entities, seize or arrest items, documents or other carriers of information, which can serve as evidence or source of evidence in a case. In the case of resistance, employees of the Anti-monopoly Committee may engage employees of the bodies of interior to carry out measures, foreseen in the law, to overcome the obstacles. It also has the right to engage employees of bodies of the interior, customs and other law-enforcement bodies to support review of cases about violations for the protection of economic competition, in particular in carrying out investigations (Article 7, Paragraph 1, Items 7-9, Law on the Anti-monopoly Committee of Ukraine). Economic entities, associations, other legal entities and individuals shall provide, upon demand by the Anti-monopoly Committee, documents and other information (including confidential information and bank secrets) needed for the protection of the economic competition (Article 22-1).

Once a formal investigation case is opened, the Anti-monopoly Committee obtains the powers such as seizure. However, an assessment of the OECD noted in 2008 that “the utility of the AMC’s seizure authority under Article 44 is severely constrained because it does not include power to conduct a search of business premises. In practical effect, in order to “seize” evidence, the AMC must know that a particular item of evidence exists and be able to specify where it is located.”³²⁴

Possibilities to challenge final decisions: Final decisions can be appealed in the economic court.

5.3.4 Conclusions

Strong competition authorities are essential for the functioning of the market economy. Meanwhile the high complexity of many competition cases together with broad and intrusive powers of competition authorities make this area particularly vulnerable to errors and/or risks of misuse.

Like in many other countries, in the Russian Federation there have been cases of erroneous decisions by the competition authority. The court practice includes cases on decisions made without sufficient investigation of the market situation, without adequate evidence or based on erroneous interpretations of the legislation. Such decisions *per se* do not attest to malicious intent. They may be caused by insufficient expertise or capacity. It must be noted positively that there is court control over decisions of the competition authorities in the Russian Federation. However, in some cases, it is probably insufficient communication during inquiries that has contributed to making of faulty decisions in the first place.

³²² *The Law On the Antimonopoly Committee of Ukraine* [Закон Украины Об Антимонопольном комитете Украины], available at <http://uazakon.ru/>

See also: Kondratieva O. (2012) *Inspections of the Antimonopoly Committee of Ukraine: the base, how to respond, and the possible consequences* [Проверки Антимонопольного комитета Украины: основания, способы реагирования и возможные последствия], available at www.uba.ua/

³²³ *The Law of Ukraine On Protection of Economic Competition* [Закон Украины О защите экономической конкуренции], available at <http://uazakon.ru/>

³²⁴ OECD (2008), *Competition Law and Policy in Ukraine*, p. 50, available at www.oecd.org/

The review of selected European countries shows that a prominent feature of anti-monopoly agencies is a relatively wide scope of intrusive powers with a requirement for a judicial warrant for steps that have the most infringing effect on fundamental/ constitutional rights of the concerned persons. It is typical that procedures of appeal to an independent court exist although the exact availability and contents of such right depend on the type of decision or action to be challenged. A growing trend in order to grant market participants apt possibilities of reaction already before final decisions are made is various forms of intense communication with competition authorities during investigation stages.

6 APPENDIX 1. THE UNITED KINGDOM: CASE LAW ON INSTANCES OF JUDICIAL STAY OF PROCEEDINGS FOLLOWING ABUSE OF PROCESS

Delay

While it is widely accepted that there will always be an elapse of time, often substantial, between date of charge and eventual trial, excessive delay may have negative consequences both for prosecution and defence witnesses alike, may cause inadvertent destruction of relevant documents as well as contributing to anxiety and expenses. Investigative authorities that fail to act promptly once a complaint is brought to their attention may see the investigation terminated through a stay of proceedings by a court.

Delay has been addressed both by the institution of time limits and by the introduction of an overarching requirement as determined by judicial discretion. The latter is often preferred in the UK as courts have the advantage of a fact sensitive approach.

In *R v. Brentford justices ex parte Wong*, the court reviewed the complaint against a prosecutor who had deliberately laid an information the day before the expiration of the time limit when it was clear that he could have done it before. The court ordered a stay of criminal proceedings as it held that the prosecutor had by this manoeuvring, deliberately attempted to gain further time and had not acted with expedition.

Implicit limitation periods to prosecution may be introduced by the relevant legislation. For example the money laundering regulations 1993³²⁵ make it an offence for a person who conducts relevant financial business not to preserve records of relevant transactions for a period of five years after those transactions have been completed. If, therefore, a prosecution were to be mounted against a person for an offence under such regulations more than five years after the transaction occurred, the accused would have an absolute defence in that he was entitled to destroy the records once the statutory period had elapsed.

Similarly an implicit limitation period has been introduced by the companies act 2006³²⁶ which requires the keeping of minutes of meetings of the company directors for a period of at least 10 years and the keeping of accounting records, a copy of the contract or memorandum of a contract for an off market purchase or a contract for a market purchase, and the directors' statement and auditor's report for inspection, all for defined minimum periods of time.

After the introduction of the human rights act the jurisprudence of the courts strengthened the right to a trial within a reasonable time to the point that they held that it is a freestanding constitutional guarantee and that proof of prejudice was not essential anymore as long as the delay had been inordinate and expensive. In such cases it has been held that the right to a trial within a reasonable time conferred a correlative right not to be tried after the expiry of a reasonable time³²⁷.

However stay of proceedings is a remedy that the court can grant but are not required to grant when other remedies are available such a reduction in sentence or an award of compensation. The appropriate remedy will depend on the nature of the breach and all the circumstances³²⁸. While it will not be appropriate to stay or dismiss the proceedings unless there can be no longer a fair hearing or it would otherwise be unfair to try the defendant. However there are still cases where the prosecutor's breach of professional duty is such as to make it unfair that the proceedings against a defendant should continue

³²⁵ *The Money Laundering Regulations (1993)*, available at www.legislation.gov.uk/

³²⁶ *Companies Act (2006)*, available at www.legislation.gov.uk/

³²⁷ A.L.T. Choo (2008), *Abuse of Process and Judicial Stays of Criminal Proceedings* (Oxford Monographs on Criminal Law and Justice); Colin Wells (28 Feb 2011), *Abuse of Process*, Jordans Ed.

³²⁸ David Corker, David Young and Mark Summers (19 Apr 2008), *Abuse of Process in Criminal Proceedings*, Tottel Ed.

Breach of promise

In certain cases, there may be an abuse of process when the prosecution reneges on a promise not to prosecute.

In the case *R v. Croydon Justices, ex p Dean*³²⁹ the court held that the prosecution of a person who had received a promise, undertaking or representation from the police that he would not be prosecuted earlier was capable of being an abuse of process. The court in the circumstances of the case noted that the impression created was not dispelled for over five years, during which period the applicant gave repeated assistance to the police. The timing of the police promise to use him as a witness, and rule him out as a defendant, was also a feature given that the promise was given at an early stage before he provided the important information. Such approach has determined the outmost care with which now police will for example conduct discussions with a suspect or his legal representative where impression may be conveyed that if a suspect cooperates as desired, others but not him will be charged: informing a suspect that he will be a prosecution witness might be now construed as an implied promise that no prosecution will take place.

Equally, in the *R v. D* case the court of appeal found that an abuse of process had taken place when the police went back on their words and re-instituted proceedings which had been dropped several years before for insufficient evidence. The court of appeal did not consider the prosecution's stated reasons for reviving proceedings to be an adequate explanation or justification and also took into account the antiquity of proceedings, the fact that the defence had been deprived of vital documentation (destroyed by the passage of time) which was found to have caused obvious and substantial prejudice to the preparation of the case.

Following the passing of the 2004 Code for Crown Prosecutors guidelines have been issued concerning the re-starting of a prosecution that clearly states the conditions under which a decision to restart a prosecution that has been stopped can be adopted for:

- a) Rare cases where a new look at the original decision shows that it was clearly wrong\--cases that had been stopped so that more evidence which is likely to become available in the near future can be collected and prepared (in which case the defendant must be informed that the prosecution may well start again);
- b) Cases when significant evidence is discovered later. Usually also in cases when an investigation is discontinued on the basis of a particular stated reason and then on some occasion thereafter the prosecution seeks to restart proceedings on the basis of a different reason altogether, raise questions of abuse of process.

The principle of crown divisibility according to which branches of government can pursue separate agendas and policies has determined that no question of abuse of process was raised by the court when the inland revenue had elected not to prosecute for tax evasion but instead to accept tax, penalties and interests while the crown opted for the opening of a criminal case against the applicant *R v. W.*

On the other hand, in practice, when the Inland Revenue accepts a money settlement instead of instituting legal proceedings in respect of fraud alleged to have been committed by the taxpayer (the so called Hansard policy³³⁰), prosecutions are rare.

³²⁹ Ying Hui Tan (1993), *Law Report: Prosecution was abuse of process: Regina v Croydon Justices, Ex parte Dean - Queen's Bench Divisional Court (Lord Justice Staughton and Mr Justice Buckley)*, The independant, available at www.independent.co.uk/

³³⁰ The National archive, SCIG06370 - *Code 9 cases registered prior to 1/9/05 (Hansard): The opening Hansard meeting: Hansard Statement*, available at www.hmrc.gov.uk/

Abuse of process stemming from loss or destruction of evidence

Instances whereby the prosecution has failed to obtain or retain material evidence have also led to applications to stay proceedings. The conditions under which the loss of evidence has led to stay of proceedings are:

- a) When the loss cannot be remedied;
- b) When it has seriously prejudiced the preparation and conduct of the defence;
- c) When the problem cannot be remedied at trial by, for example, ruling on admissibility of certain evidence;
- d) When it can be proved that there has been bad faith or at least serious fault on the part of the police or prosecution authorities.

In the latter circumstance a stay may be granted even irrespective of whether a fair trial was possible, as proceeding to trial would bring the administration of justice into disrepute. Such an approach also serves as a clear warning to the police and prosecuting authorities that certain levels of bad conduct on their part, may well lead to a stay of the proceedings. Investigators are required to err on the side of recording and retaining material where they have any doubt as to whether it may be relevant.³³¹

Abuse of process due to failure to pursue all reasonable lines of inquiry

The CPIA (Criminal procedure and investigation act)³³² has introduced the most significant and wide ranging obligation cast on criminal investigators as it holds that in conducting an investigation, the investigator should pursue all reasonable lines of inquiry, whether these point towards or away from the suspect. This rules means that an investigator must recognise where there is material that is relevant for the investigation, that he must make steps to retain it.

The 2005 attorney general guidelines³³³ have also introduced a duty on the part of investigators to be proactive in seeking material evidence for example by approaching other stat authorities who may be in possession of relevant evidence, by not leaving a matter just because a third party declines or refuses to allow access to information or material sought.

The duty of investigation should also be proportionate to the seriousness of the matter being investigated.

In 2006 the court of appeal has also issued a protocol on unused material³³⁴ finally regulating in detail such matters.

Abuse of process by manipulation of custody time limits

The underlying policy of custody time limits is to minimise the period spent by the accused in custody awaiting trial. It obliges the prosecution to prepare a case diligently and to allow the court power to determine whether there should be any extension to the maximum period. On occasions an accused held in custody is originally charged with one offence but subsequently another is substituted so that a new time limit would start. This situation can give rise to a complaint of prosecution manipulation and abuse, provided that its goal was to ensure that an accused is kept in custody for a longer period. In the case *R (Wardle) v. Crown Court at Leeds* the House of Lords³³⁵ held that in such instances a new custody time limit would not begin if the new charge were brought in bad faith or dishonestly.

³³¹ David Corker, David Young and Mark Summers (19 Apr 2008) *Abuse of Process in Criminal Proceedings* Tottel Ed.

³³² *Criminal procedure and investigation act* (1996), available at www.xact.org.uk/

³³³ CPS, *Attorney General's Guidelines On Disclosure*, available at www.cps.gov.uk/

³³⁴ Court of Appeal, *Disclosure: a protocol for the control and management of unused material in the crown court*, available at www.judiciary.gov.uk/

³³⁵ House of Lords, *Judgments - Regina v. Leeds Crown Court Ex Parte Wardle*, available at www.publications.parliament.uk/

Abuse of process due to prosecutor's improper motive

Allegations of improper motive normally arise when an applicant alleges that the underlying motive of the prosecutor is revenge, obsession or some wholly collateral motive to cause embarrassment to the defendant. In this respect the British courts tend to admit such types of prosecution unless there is very clear evidence of improper motive. In the *R v. Durham Magistrates' court, ex p Davies*³³⁶ the prosecutor was alleged to be obsessed with achieving the successful prosecution of the defendant. The court disagreed and held such ulterior motivation as irrelevant. It however held that an abuse of process might arise if the prosecution was oppressive or frivolous, in which case a judge may intervene and stay the proceedings.

In the *R v. Milton Keynes Magistrates, ex p Roberts* the court held that a stay could be imposed if a prosecutor did make himself the creature of private interest in exercising his powers. The prosecution would be stopped, if the permission to allow it to continue would be tantamount to endorsing behaviour which undermines or degrades the rule of law or is an affront to justice. In the *R (Dacre and associated newspapers) v. City of Westminster magistrate's court* case³³⁷, the court held that an abuse may arise if there was a primary motive for a prosecution that was so removed from the proceedings that it rendered the prosecution a misuse or an abuse of process.

Abuse of process due to prosecution overcharging

In the case *R v. Harlow Magistrates court, ex p O'Farrell*³³⁸, the court held that an abuse had taken place when the prosecution had sought to add an additional and more serious charge based on the same facts, after the bench had retired to consider its verdict on the original charge. The court reasoned that adding a charge at this stage of the proceedings would prejudice the defence case, which had already been pleaded in relation to the original charge.

Abuse of process based on disparity of treatment between co-defendants

In the *R v. Petch and Coleman* case³³⁹, the court held that an abuse of process may arise when a secondary co-defendant at a later trial was convicted for murder when previous trial against co-defendants based upon the same events as earlier trials had only been convicted for manslaughter as such situation would create a particular sense of grievance.

Abuse of process following repeated committal proceedings

In *R v. Manchester City stipendiary magistrates ex p Snelson*³⁴⁰ the court held that there would be a risk of abuse of process when a prosecution was restarted by way of fresh committal proceedings even when the original proceedings against the defendant at committal had been dismissed as such practice posed a danger of vexatious repeated committal proceedings for the same offence against the same defendant. On these grounds in the case *R v. Horsham Justices ex p Reeves*³⁴¹ the court held that repeated committal of a defendant was vexatious and therefore an abuse.

Abuse of process on the grounds of failure to conduct a fair interview

In the case *R v. Trustham*³⁴² the accused, who was accused of drug-money laundering, was arrested but never interviewed and simply charged instead. The court held that the case should be stayed as the defendant was prejudiced by having been deprived of the right to give an explanation at the earliest opportunity, despite being cautioned that anything he said would be recorded and used in evidence.

³³⁶ Ying Hui Tan (1993), *Law Report: Prosecution was abuse of process: Regina v Croydon Justices, Ex parte Dean - Queen's Bench Divisional Court (Lord Justice Staughton and Mr Justice Buckley)*, The independent, available at www.independent.co.uk/

³³⁷ *Dacre v City of Westminster Magistrates Court* (2008), available at www.familylawweek.co.uk/

³³⁸ *R v Harlow Magistrates' Court, ex parte O'Farrell*, available at <http://lexisweb.co.uk/>

³³⁹ *Thomas Petch & George Romero Coleman*, available at www.bailii.org/

³⁴⁰ *R v. Manchester City Stipendiary Magistrate, e p Snelson* [1978] 2 All ER 62

³⁴¹ *Horsham Justices, Ex parte Reeves* (Note) (1980) 75 Cr.App.R. 236

³⁴² *R v. Trustham Southwark Crown Court* 27 November 1997, Unreported

Abuse of process based on contact with witnesses

In the *R v. Evans* case the court held that although it was proper for either the defence or prosecution to meet with witnesses who were intended to give evidence for the opposite side and that arranging such a meeting for the purpose of seeking the witness to change their evidence was permissible, an abuse of process may arise if undue pressure was applied to witnesses. In the *R v. Schlesinger*³⁴³ case the court held that machinations to prevent potential witnesses from giving evidence were held to be an abuse. Besides this it is accepted that to threaten or offer a witness an inducement in return for the witness changing his evidence is an abuse.

Abuse of process based on selective prosecution

Although it is admitted that prosecutors are permitted to choose as to when to prosecute and when not to prosecute, such choice must be fair, especially when the evidence is largely similar. Any form of discrimination or favouritism is considered unlawful or *ultra vires*, and amounts to abuse of process.

In UK the prosecuting agency which had the most developed policy and practice concerned with selective prosecution is the Inland Revenue who only choose to prosecute a small proportion of those against whom there is sufficient material to prosecute for tax fraud. For the majority of cases in fact the priority is given to reaching a settlement whereby the tax plus interest and penalties is paid over.

The Inland Revenue has since 1999 published its prosecution policy³⁴⁴. According to this policy, examples of the kind of circumstances in which HMRC will generally consider commencing a criminal, rather than civil investigation are:

- In cases of organised criminal gangs attacking the tax system or systematic frauds where losses represents a serious threat to the tax base, including conspiracy;
- Where an individual holds a position of trust or responsibility;
- Where materially false statements are made or materially false documents are provided in the course of a civil investigation;
- Where, pursuing an avoidance scheme, reliance is placed on a false or altered document or such reliance or material facts are misrepresented to enhance the credibility of a scheme;
- Where deliberate concealment, deception, conspiracy or corruption is suspected;
- In cases involving the use of false or forged documents;
- In cases involving importation or exportation breaching prohibitions and restrictions;
- In cases involving money laundering with particular focus on advisors, accountants, solicitors and others acting in a 'professional' capacity who provide the means to put tainted money out of reach of law enforcement;
- Where the perpetrator has committed previous offences / there is a repeated course of unlawful conduct or previous civil action;
- In cases involving theft, or the misuse or un lawful destruction of HMRC documents;
- Where there is evidence of assault on, threats to, or the impersonation of HMRC officials;
- Where there is a link to suspected wider criminality, whether domestic or international, involving offences not under the administration of HMRC.

When considering whether a case should be investigated using the civil fraud investigation procedures or is the subject of a criminal investigation, one factor will be whether the taxpayer(s) has made a complete and unprompted disclosure of the offences committed.

However, there are certain fiscal offences where HMRC will not usually adopt the civil fraud investigation procedures under Code of Practice 9. Examples of these are:

³⁴³ Anti-Cyber Forensics, *R v Schlesinger; R v Dunk; R v Atlantic Commercial Ltd (United Kingdom)*, available at <http://anticyberforensics.wordpress.com/>

³⁴⁴ *HMRC Criminal Investigation Policy*, available at www.hmrc.gov.uk/

- Vat 'Bogus' registration repayment fraud;
- Organised Tax Credit fraud.

As for criminal trials it is sometimes alleged that a prosecution witness has fabricated or embroidered his evidence as a means of escaping prosecution he was facing. Accordingly his evidence should be disregarded and in most cases the credibility of his accusation is a matter for the jury and no abuses arise. An abuse may arise however when there has been collusion between the suspect turned witness and the investigators if the suspect was offered an inducement to give false evidence by the investigators, this being a promise of immunity for him or a friend or relative. It is considered that the prosecution is therefore tainted by this impropriety and is unfair.

This situation arose in *R v. Bigley*³⁴⁵ where several individuals were arrested for drug offences. Each was interviewed under caution and some of them, during the interview, incriminated the defendant. Having done so, those individuals were then offered immunity from prosecution in return for agreeing to become prosecution witnesses and this offer was taken up. The court held that as a matter of principle it was acceptable for a prosecutor to decide not to prosecute those guilty of more serious offences. In this case the court dismissed the allegations of abuse as even before the prosecutors had decided to prosecute or not, the suspects turned witnesses had, during the interviews, given incriminating statements against the defendant without any promise of reward by the investigators. Overall in UK investigators and prosecutors will need always to be mindful of allegations of collusion and improper inducement in a trial where an important prosecution witness against whom there was sufficient evidence of criminality to mount a prosecution had nonetheless never been prosecuted.

Abuse of process based on non-disclosure

As a right to fair disclosure of evidence is strictly connected to the right to fair trial an abuse of process may arise if it is discovered that the prosecution has not disclosed material that may be reasonably be considered capable of undermining the prosecution case or assisting the case for the accused. For this purpose the attorney general in 2005 issues guidelines on the disclosure of unused material in criminal proceedings. Examples of unfairness in disclosure practice include failure by the prosecutor to comply with their obligations to provide proper disclosure, exceptionally late disclosure of material, inadvertent or misleading in relation to non-sensitive or sensitive material³⁴⁶.

Depending on the circumstances, some complaints will be met with disclosure, others by granting of adjournments to the defence when, met with very late disclosure, or by exclusion of evidence or suitable judicial directions to the jury.

Examples of non-disclosure giving rise to abuse are the *R v. Blackledge*³⁴⁷ case where following guilty pleas it was found out that exculpatory evidence had been withheld from the defence. This material whilst not affording a defence to the offence charged, would have enabled the accused to mount an abuse application. The court eventually quashed the convictions of all accused on the ground of non-disclosure.

In the *R v. Humphreys*³⁴⁸ case the court eventually stayed the proceedings as it noted substantial failures to retain and record relevant material, repeatedly late disclosure, selective disclosure and the flouting of judicial orders in relation to disclosure. The cumulative effect was found to undermine the confidence in and respect for the rule of law.

In the case *R v. Docker* disapproval for police misconduct, amongst allegations of fabricating evidence, coupled with non-disclosure by the police acted as the basis of stay of proceedings. Section 10(2) of the Criminal Procedure and Investigations Act (CPIA) has expressly introduced the

³⁴⁵ *R v Bigley*, available at <http://lexisweb.co.uk/>

³⁴⁶ David Corker, David Young and Mark Summers (19 Apr 2008), *Abuse of Process in Criminal Proceedings*, Tottel Ed.

³⁴⁷ *R v Blackledge*, available at www.deathpenaltyproject.org/

³⁴⁸ *R v. Humphreys* [1995] 4 All ER 1008 Court of Appeal

possibility to stay proceedings when prosecution have consistently failed to adhere to time limits, perhaps finally serving materials of crucial significance at trial itself.

Abuse of process based on public interest immunity

The power of prosecutors to obtain judicial permission not to disclose material to the defence on the grounds of public interest has become heavily proscribed following the House of Lords judgment in the case *R v. H and C*. If the sole or dominant motivation to obtain such permission is to gain a forensic advantage, to withhold material that may embarrass the prosecution or strengthen the defence, or even worse, preventing the accused of receiving a fair trial, then it should never be made.

In the case *R v. Patel* the court held that, when such abuse had taken place, the defendants convictions should be quashed even if there was, in the opinion of the prosecution sufficient evidence of their guilt.

In the case *R v. early eight appellants* obtained a stay of proceedings on abuse of process grounds, as they had pleaded guilty, first, on the false assumption that full and proper disclosure had been made to them by the prosecution. The court found that guilty pleas were no bar to preventing the quashing of the convictions.

Abuse of process due to unlawfully obtained evidence

Although the fact the evidence unlawfully obtained does not lead to automatic exclusion when such evidence was obtained by torture.

Another instance where the proceedings were stayed was the *R v. Stapleton* case where the accused were charged with VAT fraud following a very lengthy and surveillance operation mounted by the police. The defence argued abuse on the ground of bad faith and abuse of power, that the authorities were determined to apprehend one of the accused for some crime, and that, in reality, the real motive for the surveillance was not suspicion of on-going criminal activity by an arbitrary and wholesale investigation of the accused. As such, this *ad hominem* investigation was impermissible and in any event in this particular case was wholly disproportionate.

Abuse of process based on commission of criminal offences or unlawful conduct by investigators

In the *R v. Schlesinger*³⁴⁹ case the appellants had been convicted in 1985 of having illegally exported arms to Iraq. Before their trial, the defence became aware of various embassy officials in London who were prepared to state that the arms had not in fact gone to Iraq. However, before witness statements could be taken, the officials announced they could no longer assist, their permission to do so from their embassies having been withdrawn. In the event the defendants pleaded guilty.

Following an inquiry in 1993 it was disclosed that the foreign office, at the behest of customs (the prosecutorial agency) had urged the embassies not to allow their officials to assist the defence. When this information was published, the defendants appealed against their convictions. The court of appeal readily quashed the convictions as it held that the prosecution had, in the first instance, improperly interfered with the course of justice and secondly, had concealed this from the defence and trial judge. In holding abuse, the court held that a defendant does not receive a fair trial if the prosecution from calling witnesses who are believed to be helpful to the defence prevents him.

In the *R v. Latif*³⁵⁰ case the House of Lords noted that if a court always refused to stay proceedings when investigators commit offences or hold unlawful conduct, the perception will be that the court condones criminal conduct and malpractice by law enforcement agencies. On the other hand if it were always to stay proceedings on such grounds it would incur in reproach for failing to protect the public from serious crime. It further held that in such cases the court had discretion which ought to be based

³⁴⁹ Anti-Cyber Forensics, *R v Schlesinger; R v Dunk; R v Atlantic Commercial Ltd*, available at <http://anticyberforensics.wordpress.com/>

³⁵⁰ Ying Hui Tan (1996), *Trial for drug offences not an abuse of process*, available at www.independent.co.uk/

on the circumstances of the case: for example if the conduct of the investigator was so unworthy, or shameful that it was an affront to the public conscience to allow the prosecution to proceed.

In the *Latif* case the court introduced a balancing exercise between two competing public interests: the imperative for the courts to preserve their moral integrity by dissociating themselves from investigative impropriety. The fair administration of justice cannot be sacrificed in the name of expedience. Second those charged and convicted of serious crimes should not escape justice because such situation would undermine public confidence in the criminal justice system.

The key principles for a stay based on abuse of process are the following: that a crime was already in existence and had not been incited, that the investigator was acting under the authority of his superiors and was motivated by the desire to ensure the punishment of criminals, that the degree of criminality of the investigator was considerably lower (venial) as compared to the one of the defendants.

An application of these principles took place in the *R v. Khan* case where a Thai diplomat had been searched following his arrival at Heathrow airport and a quantity of heroin in his diplomatic bag was found. He applied for a stay of proceedings on the grounds that the searches had been in violation of his diplomatic immunity in breach of the Vienna convention. The trial judge was not impressed by his argument and dismissed the diplomat's application.

In the *R v. Carrington* case the defendant were charged with drug trafficking on a boat from Malta to the UK. As international maritime law required that before the boat could be intercepted and boarded by customs agents the consent was required of the Attorney General of Malta as the boat had stated its voyage from there. However customs did not want to wait until the boat entered the territorial waters to track the boat and board it, but wished to do so in the high seas.

It was discovered that when the consent of the attorney general of Malta had been sought, he had been informed by customs that the location of the boat was "off the coast of the UK" which was a false representation. The court held that as such decision to mislead the Maltese authorities was shameful, the consent obtained in mala fides and a stay was necessary.

In the *R v. Sutherland*³⁵¹ case the court held that the decision of the investigators to eavesdrop conversations between suspects of murder and their attorney while they were detained at police station was such a grave violation of a fundamental principle of law and human rights. It was hence immaterial whether the eavesdropping had effectively prejudiced the accused.

Abuse of process based on Illegitimate funding of the prosecution

In the case *R v. Hounsham*³⁵² and others the proceedings had been opened against car dealers for working in consort to defraud motor insurers by making false insurance claims in respect of staged traffic accidents. Towards the ends of the proceedings it was disclosed to the defendants that the insurance companies in question had funded the police investigations that had resulted in their arrest. The police in fact by seeking and accepting payments from the insurance companies had acted ultra vires their statutory powers. The court noted that such practice posed a serious danger to the objectivity of the police and may lead the police to become selective as to which crimes to investigate, lead to victims persuading a police investigation team to act partially, to lead investigators to carry out a more thorough preparation of the case of a paying victim. However as no prejudice was proved by the accused, the court held that no abuse of process could be declared in the instant case.

³⁵¹ *Regina v Robert Sutherland, Gary Self, Danny Gray, John Smith, John Toseland*, available at <https://docs.google.com/>; Cited in *Annual Report of the Chief Surveillance Commissioner to the Prime Minister and to Scottish Ministers for 2003-2004*, available at www.gov.uk/government/

³⁵² *R v Hounsham*, available at <http://lexisweb.co.uk>

Abuse of process following entrapment

In the R v. Looseley case³⁵³ the House of Lords stated that in instances where entrapment is used to lure citizens into committing crimes, there is a state created crime that should not be condoned, so a stay should be granted. In fact the courts must ensure that the state does not abuse its power and misuse the coercive law enforcement functions of the courts and thereby oppress citizens of the state. The role of the courts is to stand between the state and its citizens and make sure this does not happen. In the case Looseley the court held that even if in the specific circumstances of the case a fair trial was still possible, the case should be terminated on the grounds of broader considerations of the integrity of the criminal justice system. The British courts have also specified the criteria to determine whether an entrapment had taken place: if there were reasonable grounds for suspecting an individual of on-going involvement in a particular crime. The suspicion may be centred not necessarily on a specific individual but on a specific location where a certain crime is prevalent. In order to lawfully resort to agent provocateurs the courts have also established that appropriate authorisation and supervision had been sought by the investigators and that the conduct of the undercover officer was monitored during the currency of the operation.

The courts have also reviewed the nature and extent of State participation in the crime³⁵⁴:

- Proactive conducts of officers may be acceptable in relation to consensual crimes which otherwise will be difficult to prosecute (this is the case of drug crimes where victims rarely report a crime). In other words, such is the nature of the offence that evidence will only be obtained if undercover methods are used;
- The degree of intrusiveness is proportionate to the seriousness of the suspected offence;
- The state has given the accused an unexceptional opportunity to break the law.

In *Ridgeway v. R*³⁵⁵ the court held that the state can justify the use of entrapment techniques to induce the commission of an offence only when the inducement is consistent with the ordinary temptations and stratagems that are likely to be encountered in the course of criminal activity. But once the state goes beyond the ordinary, it is likely to increase the incidence of crimes by artificial means. The court held that for example if the accused was approached several times before agreeing to commit the offence, the state will need to justify why such persistence or persuasion was necessary and was not tantamount to inadmissible incitement.

In cases where the courts may not deem it necessary to stay proceedings, as the crime could not be considered as state created, it may still be possible to obtain a mitigation of the sentence based on the view that the defendant may not have committed the offence had it not been for the actions of the entraper (R v. Underhill). More recently however, in the R v. Springer case³⁵⁶, the court of appeal held that where undercover officers purchased drugs from established dealers that would not afford mitigation in sentence.

Abuse of process based on double jeopardy

The principle of double jeopardy entails that a defendant should not be tried twice on the same general allegations. This prohibition is intended to prevent re-litigation of similar factual issues and, in the context of crime, to prevent overzealous prosecutors seeking to retry the same defendant against whom a court has dismissed a previous prosecution. It also prevents a prosecutor where proceedings have resulted successfully with a conviction but one that is perceived as only being a precursor or dummy run to subsequent more grave allegations. In fact the defendant may, as a result of having revealed his complete defence at the first trial, be at a greater disadvantage at the second trial and thus

³⁵³ House of Lords, *Judgments - Regina v Looseley*, available at <http://www.publications.parliament.uk/>

³⁵⁴ David Corker, David Young and Mark Summers (19 Apr 2008), *Abuse of Process in Criminal Proceedings*, Tottel Ed.

³⁵⁵ *Ridgeway v The Queen*(1995) 184 CLR 19 at 32

³⁵⁶ *R v. Springer* [1998] CLR 912

less able to defend himself effectively. Irrespective of this, it is also considered morally objectionable to subject someone to the embarrassment, expenses and anxiety of a second prosecution³⁵⁷.

In order to bar a second prosecution the British courts have established that the offence must be the same in fact and law.

Under British doctrine of double jeopardy it is also prohibited to try a person for an offence in respect of which they could have been in previous proceedings lawfully convicted. Where the offence tried in the earlier proceedings, in which the defendant was either convicted or acquitted, constituted an alternative to the offence now proposed to be tried. The British courts consider in fact that in such instances the defendant has already been implicitly acquitted or convicted.

Another principle is if the offence, in respect of which a person is to be tried, is the same or substantially the same as that in respect of which they were in previous proceedings acquitted or convicted. This rule however applies if the offence charged in the second indictment has been committed at the same time as the first alleged offence. To identify if this is the case, the courts will usually check if the evidence necessary to support the second charge would have been sufficient to prove a legal conviction on the first.

In order to apply the double jeopardy exception it is also necessary that a defendant's guilt has been decided upon and was adjudicated (made by a court of competent jurisdiction). Such adjudication includes both cases when a verdict has been adopted and when a guilty plea has been entered and accepted.

On the other hand an acquittal in criminal proceedings does not constitute a bar to civil proceedings pursued to obtain compensation for damages. In the *Raja v. Hoogstraten* case³⁵⁸, the high court had regard to the lower standard of proof in civil proceedings and the different rules relating to admissibility of evidence.

Abuse of process based on separate prosecutions by different prosecution agencies

In the case *R v. Beedie* a tenant died of carbon monoxide poisoning caused by defects in a gas fire in premises owned by the defendant landlord. The death was investigated by a variety of agencies including the health and safety executive and the police. Before the police reported to the crown prosecution concerning a prosecution by it, the landlord had been already charged and convicted at the behest of the health and safety executive in relation to offences against the health and safety at work act of 1974. Furthermore the local authority had prosecuted him in relation to dangerous gas fires. Only after these two convictions and an inquest was the landlord charged with manslaughter by the police and the case taken up by the crown prosecution. In his appeal against such third trial the defendant relied on a rule (established in the *Connelly* case) according to which, apart from special circumstances, there should be no sequential trials on an ascending scale of gravity. The court of appeal agreed with his request to stay proceedings.

Abuse of process based on repeated committal proceedings

In *R v. Manchester city stipendiary magistrates, ex p S Nelson*³⁵⁹ it was held that discharge at committal proceedings did not prohibit fresh committal proceedings for the same offence. However in *R v. Horsham Justices, ex p Reeves*³⁶⁰ it was held that the second set of committal proceedings should be stayed as an abuse. The court held that in this case the prosecution had treated the first set of proceedings as a dummy run and having learned lessons had brought the same proceedings albeit in simplified form. The court noted that such stay would discourage poor preparation as well as waste of time and money.

³⁵⁷ David Corker, David Young and Mark Summers (19 Apr 2008), *Abuse of Process in Criminal Proceedings*, Tottel Ed.

³⁵⁸ *British and Irish Legal Information Institute* is available at www.bailii.org/

³⁵⁹ *Regina -v- Manchester City Stipendiary Magistrate, ex parte S Nelson* [1977] 1 WLR 911

³⁶⁰ cited above

Abuse of process based on pre-trial publicity

It has long been recognised by British courts that pre-trial publicity can inhibit a fair trial, especially in a context where all major crimes are decided on by a jury and not by professional judges. Pursuant to the contempt of court act a judge seized of active proceedings is empowered to make an order banning publication for a defined period of those proceedings in order to avoid substantial risk of prejudice to the administration of justice and in particular for the defendant to the extent that a fair trial cannot be held. In the *R v. Abu Hamza* case³⁶¹, the lord chief justice held that a stay of proceedings would be possible in those exceptional cases where the effect of publicity has been so extreme that it is not possible to expect the jury to disregard it.

As an alternative to stay of proceedings on the grounds that pre-trial publicity put at risk the fairness of the trial it also possible to move the trial venue to a different geographical location, especially if the prejudice was caused by local publicity. This is however not possible when the adverse publicity is national. It is also possible for the judge to give adequate instructions to the jury or to delay the start of the trial to allow feeling of prejudice to subside.

³⁶¹ *Abu Hamza* (2007) 3 All ER 451 (*pre-trial publicity*), see also the relevant ECtHR decisions at : <http://hudoc.echr.coe.int/>

7 APPENDIX 2. BODIES THAT MAY REQUEST LIQUIDATION OF A LEGAL ENTITY AND GROUNDS FOR SUCH REQUEST IN THE RUSSIAN FEDERATION

The registration authority may apply to the court demanding the liquidation of a legal person if, upon its establishment, repeated or gross violations of the law or other legal acts, including of an unrecoverable character, took place.

State or local government bodies, which have such authority according to the law, may apply to the court demanding the liquidation of a legal person. In accordance with the legislation of the Russian Federation, in particular the following bodies have the right to apply to the court for the liquidation of legal entities.

1. The bodies responsible for the State registration of legal entities (registrars): According to part 2 Article 25 of the law №129-FZ of August 8, 2001 “On the State registration of legal entities” the registration authority may apply to a Court with a demand for the liquidation of a legal person in the following cases:

- a grave violation of a law or other legal act has been committed at the formation of such a legal entity, provided the violation is of irreparable nature;
- a repeated or grave violation of laws or other regulatory legal acts on the state registration of legal entities has been committed.

Registering bodies also have the right to go to court with claims about the liquidation of legal persons in the cases provided for by law, including:

- in the case of incomplete payment of the charter capital of a limited liability company within the statutory limit and the failure of society in connection with the decision to decrease its charter capital;
- in the case of incomplete payment of shares of the joint-stock company within the prescribed time limit and failure of society in connection with the decision to decrease its charter capital;
- if at the end of the statutory period, the net asset value of the limited liability company was less than its charter capital and the company did not reduce its share capital, as well as the company's net assets value is less than the minimum amount of the authorised capital and society has not taken a decision on its liquidation;
- if at the end of the statutory period net asset value of a joint-stock company was less than its charter capital and the company did not reduce its share capital, as well as the company's net assets value is less than the minimum amount of the authorised capital and society has not taken a decision on its liquidation;
- in cases when limited liability companies (limited liability partnerships) created before the enactment of the Federal Law №14-FZ of February 8, 1998 “On limited liability companies” did not bring their founding document in compliance with the law or transform into joint stock companies or production co-operatives within the prescribed period;
- if the individual (family) private enterprises, as well as enterprises established by business partnerships and companies, public and religious organisations, associations, foundations, and other enterprises not in State or municipal ownership, based on the right of economic management, before July 1, 1999 did not transform into business partnerships, societies or cooperatives or did not liquidate themselves;
- in case when a legal person registered before July 1, 2002, fails to provide to the registration body information according to sub-items a-d, 1 of item 1 Article 5 of the Federal Law “On the State registration of legal entities” before December 31, 2002.

2. Tax authorities shall have the right to initiate legal action in the courts of general jurisdiction or courts of arbitration for the liquidation of entities of any organisational-legal form on the grounds established by the legislation of the Russian Federation. In particular, the tax authorities shall have the right to seek the liquidation of legal entities that violated laws of other legal acts flagrantly or repeatedly in carrying out their activities.

The tax authorities shall have the right to go to court with claims about the liquidation of legal persons, in particular, in cases of repeated or gross violations of the tax legislation. Such a breach could be, for example, a systematic failure to submit reports about financial-economic activities as well as documents and information for tax calculation and payment.

In accordance with the paragraph 5 of Article 6 of the Law of the Russian Federation of June 18, 1993 No. 5215-1 “On the use of cash registries in money settlements with the population”, the tax authorities are obliged, upon repeated violations by the legal entity of this Law and regulations on the use of cash registers, to apply to the court for the liquidation of the legal entity with a simultaneous suspension of its activities related to monetary settlements with the population, including the prohibition of disposal with its means in bank accounts.

3. The Federal competition authority (territorial authority within its competence) shall have the right to apply to the court for the liquidation of an alliance of commercial organisations (unions or associations), business companies or partnerships if they coordinate the entrepreneurial activities of commercial organisations, which have or may have the effect of restricting competition.

4. The Central Bank of the Russian Federation (Bank of Russia) shall have the right to make a claim in the court of arbitration on the liquidation of a legal person engaged in unlicensed banking operations.

5. An authorised State in the area of non-government pension provision may submit claims for the liquidation of non-State pension funds, which operate without a licence.

6. Any concerned person may submit a claim for the liquidation of the fund. In accordance with item 2 of Article 119 of the Civil Code, only the court may make a decision on the liquidation of the fund upon an application by the concerned persons (a body of the fund authorised by the founding documents and founders (participants) of the fund).

A variety of illegal and semi-legal methods are used in different countries in corporate conflicts, in attempts to eliminate competition and in forced takeovers of legal entities. Typically the perpetrators are unscrupulous businesspeople or even organised crime groups. Occasionally public authorities are involved in such struggles either because the private adversaries misuse official procedures or the authorities misuse their powers and collude with some of the parties. Among the most dangerous areas of misuse are criminal inquiries and proceedings and court decisions.

The analysis keeps a particular focus on the Russian Federation. Based on a selective approach, cases for comparison are drawn from France, Germany, Italy, Latvia, Norway, Spain, Switzerland, Ukraine, the United Kingdom and other countries.

Through the joint project on the “Protection of the Rights of Entrepreneurs in the Russian Federation from Corrupt Practices” - PRECOP RF - the European Union and the Council of Europe in cooperation with the Business Ombudsman’s Office in the Russian Federation aims to facilitate and contribute to the implementation of mechanisms to prevent corrupt practices affecting the business sector in the Russian Federation. Specifically, the project will strengthen the capacity of the Business Ombudsman institutions and other authorities involved in protecting the rights of entrepreneurs in the Russian Federation from corrupt practices.

www.coe.int/precop

The Economic Crime and Cooperation Unit at the Directorate General Human Rights and Rule of Law of the Council of Europe is responsible for designing and implementing technical assistance and co-operation programmes aimed at facilitating and supporting anti-corruption, good governance and anti-money laundering reforms in the Council of Europe member states, as well as in some non-member states.

www.coe.int/corruption

The Council of Europe is the continent’s leading human rights organisation. It comprises 47 member states, 28 of which are members of the European Union. All Council of Europe member states have signed up to the European Convention on Human Rights, a treaty designed to protect human rights, democracy and the rule of law. The European Court of Human Rights oversees the implementation of the Convention in the member states.

www.coe.int

The European Union is a unique economic and political partnership between 28 democratic European countries. Its aims are peace, prosperity and freedom for its 500 million citizens – in a fairer, safer world. To make things happen, EU countries set up bodies to run the EU and adopt its legislation. The main ones are the European Parliament (representing the people of Europe), the Council of the European Union (representing national governments) and the European Commission (representing the common EU interest).

<http://europa.eu>

