Liability Briefing

February 2007

26 Store Street
London
WC1E 7BT
Tel: 020 7399 7400
Fax: 020 399 7425

Money laundering in the context of dispute resolution

There has been concern in the construction industry that those participating in dispute resolution in various roles are subject to the reporting and compliance regime of recent anti-money laundering legislation. These concerns have largely been laid to rest as a result of a decision of the Court of Appeal.

The Court of Appeal decided that participants in the ordinary conduct of litigation are not under a duty to make an authorised disclosure under S338 of the Proceeds of Crime Act 2002.

The CIC has received advice that:

- The same is likely to apply to participants in alternative dispute resolution, that is adjudicators, arbitrators, early neutral evaluators, mediators and expert determiners and expert witnesses – whether they are lawyers or non-lawyers;
- Participants are also not obliged to operate the party identification and record-keeping requirements of the Money Laundering Regulations 2003;
- Beware sham disputes, even within the ordinary conduct of litigation or alternative dispute resolution, where the dispute has been manufactured for money laundering purposes.

Discussion

1. The Proceeds of Crime Act 2002 ("POCA") and the Money Laundering Regulations 2003 ("MLR") contain provisions which potentially bring a broad band of activities within the scope of their onerous obligations. The proper interpretation of these provisions has created very real concerns about the application of the legislation to those involved in litigation and alternative dispute resolution. The Court of Appeal has however decided that the obligations do not extend to cover the ordinary conduct of litigation or those involved in providing legal services in the context of legal proceedings. The decision was not directly concerned with the activities of those supplying alternative dispute resolution services, so (*inter alia*) this guidance explains the ramifications of the judgment for them.

2. This guidance covers the activities of adjudicators, arbitrators, early neutral evaluators, mediators[1] and expert determiners[2] and expert witnesses. (You should take care to determine the exact nature of your role in any dispute and the nature of the dispute.)

3. The relevant provision of POCA is S328 which makes it a criminal offence if a person: *"… enters into or becomes concerned in an **arrangement** which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person."* Where a person acquires the relevant knowledge or suspicion of such an arrangement, the principal means of avoiding committing a criminal offence is by making a Suspicious Activity Report (SAR) to the Serious Organised Crime Agency (SOCA) (which since April 2006 incorporates the work of the National Criminal Investigation Service (NCIS).[3]

3. The relevant provision of the MLR is Regulation 2(2)(l); the need to comply with the obligations contained in the MLR apply where a person is involved in a relevant business within the regulated sector which includes: *"The provision by way of business of legal services … which involves participation in a financial or real property **transaction** (whether by assisting in the planning or execution of any such transaction or otherwise by acting for, or on behalf of, a client in any such transaction)."* This definition of relevant business also applies to POCA S330, which makes it a criminal offence for a person not to disclose any knowledge or suspicion of money laundering which comes to him in the course of that business.

4. What constitutes an *arrangement*? Does this include the outcome of legal proceedings or an alternative dispute resolution process? Similarly, what constitutes a *transaction*? Does this include litigation or an alternative dispute resolution process? Doubt as to the answers to these questions exercised those in the construction industry, until the Court of Appeal decision.

Bowman v Fels **in the Court of Appeal**

5. The facts of the case before the Court of Appeal concerned the provision of legal services in litigation, and **the Court decided that participation in litigation could not be said to constitute *"becoming concerned in an arrangement facilitating the acquisition, retention, use or control of criminal property by or on behalf of another person"*, and that S328 did not therefore apply to the ordinary conduct of litigation**.[4] The Bar Council, Law Society and NCIS intervened in the appeal to make submissions to the Court because of the importance of taking the opportunity to clarify the application of POCA and MLR to the litigation process.

6. The Court went on to decide that participation in a settlement process which led to an out-of-court settlement of litigation also fell outside the scope of S328, as settlement of a dispute formed an integral part of the conduct of civil litigation.

---

1 Including some conciliators.
2 Including engineers acting as dispute resolvers under ICE contracts.
3 See www.soca.gov.uk , 'Make a disclosure' for forms and guidance.
4 The full text of the judgment, which exceeds a hundred paragraphs, can be found at www.bailii.org (citation number [2005] EWCA Civ 226).

7. The Court did not expressly consider whether the same arguments would apply to others involved in dispute resolution, such as those referred to in paragraph 2 above. The CIC has though received advice from a QC with particular expertise in the money laundering legislation that it *"must surely follow"* from the Court of Appeal's decision that S328 does not apply to those providing dispute resolution services as an alternative to litigation. The Court of Appeal has stressed in another recent judgment the significance of mediation as an inextricable adjunct to the formal litigation process.[5]

8. As a result of the judgment, the Law Society issued revised guidance that those involved in negotiations, settlements and ADR are not involved in S328 arrangements and do not therefore need to make authorised disclosures.[6] The ADR Group also issued guidance that the exclusion of settlements of existing or contemplated litigation from S328 applies equally to mediations.

9. The Court of Appeal were anxious for reasons of policy as well as statutory interpretation that activities involving the rights and duties of individuals according to law should not be affected by POCA. The Law Society's revised guidance stresses that it follows that the qualifications of the person performing the excluded activity are not a consideration. Hence no distinction can be drawn between those participating in dispute resolution services as adjudicator, arbitrator, mediator or lawyer, and those acting as an expert witness, or preparing for and giving evidence on behalf of their client.

10. Secondly, the Court of Appeal indicated that it would construe the word "*transaction*" narrowly in the context of the provision of legal services, and that the ordinary conduct of litigation *"cannot in our view have been conceived"* to involve the carrying out of a transaction related to money laundering. It therefore follows that neither the disclosure requirements of POCA nor the need to comply with the obligations contained in the MLR are likely to be applied by a court to those concerned in the provision of dispute resolution services, whether by litigation or by alternative dispute resolution.

11. This is an important conclusion, which means that those providing dispute resolution services as an alternative to the litigation process (to include adjudicators, arbitrators, early neutral evaluators, mediators, expert witnesses and expert determiners) are not participating in relevant business within the regulated sector for the purposes of the MLR, when engaged in *bona fide* dispute resolution (see below). **They are not therefore obliged to operate the procedures of identification, record-keeping and internal reporting set out in the MLR Regulations 4, 6 and 7 whilst engaged in those activities.**

Danger areas

12. This does not mean that you can now ignore the provisions of POCA and the MLR altogether. It must always be remembered that sham litigation or sham

---

5 *Halsey v Milton Keynes General NHS Trust* [2004] I WLR 2003.

6 Bowman v Fels Money Laundering Guidance (September 2005), downloadable from www.lawsociety.org.uk.

alternative dispute resolution, created for the purpose of laundering money, remains within the ambit of S328. If the litigation or alternative dispute resolution does not involve a genuine legal and/or factual dispute then the requirement to make an authorised disclosure to SOCA remains. (The relevant forms can be found at www.soca.gov.uk – Submit a suspicious activity report.)

13. The issue will be whether you *know* or *suspect* that a sham dispute has been created for money laundering purposes. *Knowledge* includes both actual knowledge and knowledge which is imputed to a person who shuts his eyes to what is or should be obvious – described as constructive knowledge. *Suspicion* is not defined in any of the legislation but is likely to be given its ordinary English meaning: a useful definition is: *"A suspicion that something exists is more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to a slight opinion, but without sufficient evidence."* Suspicion is personal and falls far short of proof based on firm evidence. It can only be established by examining all the facts to determine whether they establish a reasonable, rather than an arbitrary or capricious, suspicion that property constitutes or represents the proceeds of crime. You are not expected to have to know the exact nature of the criminal offence or precise source of the proceeds of crime in order to determine that a transaction is suspicious.

14. POCA introduces criminal liability in the event of a failure to disclose information where there are reasonable grounds for knowledge or suspicion that another person has engaged in money laundering activities. There is therefore an *objective test* of whether knowledge or suspicion was present or ought to have existed. If an honest and reasonable person would have formed the suspicion or concluded that another person was engaged in money laundering in a particular set of circumstances then guilt can be established in the event of a failure to disclose information.

15. It is also important to note that, whilst litigation and related processes fall outside the ambit of S328, the underlying property remains "criminal property" for the purposes of the money laundering legislation. Accordingly, any future dealings with the property after the terms of any award, decision, judgment or settlement have been carried out, will require a careful re-examination of whether a Suspicious Activity Report to SOCA should be made or whether the MLR should be considered to be applicable.

This guidance can be no more than that. POCA and the MLR create criminal offences, and if any doubt arises as to particular circumstances in which you find yourself, you should familiarise yourself with the legislation and regulations and seek appropriate advice..