Judgment 39/2003

Hammerschmidt and Kells Worldwide Ltd v Barclays Bank PLC
Royal Court
(Civil Action File 712)
23rd May, 2003

Royal Court Civil Rules, 1989 – defendant's application for discovery prior to filing of defences – principles to be applied

IN THE ROYAL COURT OF THE ISLAND OF GUERNSEY

The 23rd day of May, 2003 before Alan Robin Winston Hancox Esquire, E. G. H.. C. B. E., Lieutenant Bailiff; sitting alone.

IN THE MATTER OF

WOLF-RUDIGER HAMMERSCHMIDT

First Plaintiff/
First Respondent

KELLS WORLDWIDE LIMITED

Second Plaintiff/
Second Respondent

And

BARCLAYS BANK PLC

Defendant/
Applicant

WHEREAS on the 10th April, 2003 the Lieutenant Bailiff considered an application by the Defendant dated 7th January, 2003 that the Plaintiffs do provide to the Defendant all documents in their possession, custody or control provided to the Plaintiffs by the Mercator Trust Company Ltd. or other companies connected with that company and heard thereon Advocates R. G. Shepherd and R. I. C. E. Harris Counsel for the Defendant and Plaintiffs respectively.

The Lieutenant Bailiff this day GAVE JUDGMENT in the terms attached hereto and

1. DISMISSED the said application of the Defendant
2. RESERVED the question of costs.

S. M. D. ROSS
Her Majesty's Deputy Greffier

THE ROYAL COURT OF THE ISLAND OF GUERNSEY
ORDINARY DIVISION

Between:

WOLF-RUDIGER HAMMERSCHMIDT

First Plaintiff/
First Respondent

KELLS WORLDWIDE LIMITED

Second Plaintiff/
Second Respondent

And

BARCLAYS BANK PLC

Defendant/
Applicant

Judgment on Discovery Application dated 7th January 2003.

1. By an *ex parte* Order of 27th September, 1999, the Bailiff froze the funds and/or the assets held by Barclays Bank Plc (Barclays) for, in the name of or to the Order of Kells Worldwide Ltd, a company incorporated on 26th June, 1997, (Kells) who were therein described as the Defendant, but which is now the Second Plaintiff in the substantive action tabled on 17th September, 2002. The Order was in addition specifically directed to funds (a) which were the subject of Deal Numbers 56681400, 66075288 and 66164199 or (b) which are, or were previously held in (Kells') account Number 43713233. The usual appurtenant order for disclosure, directed to Barclays, was included as set out in paragraphs 2 and 3 of the Order. It was renewed for a further year on 22nd September, 2000.

2. As a result of the disclosures required under the second limb of the Order and made by the appropriate officer of Barclays on 7th October, 1999, the First Plaintiff learned of the matters which are now allegations of fact appearing at (a) to (e) of paragraph 35 of the Cause, It was by this means also that the Plaintiff then learned of the fraudulent Scheme related in elaborate detail in paragraphs 3 to 9 of the Cause. The Action was placed on the Pleading List on 4th October, 2002, almost three years after the Plaintiff had received the information from the Bank, and there are the usual allegations and counter-allegations in the correspondence as to which side was to blame for the delay.

3. The fraudulent Scheme is alleged to have been perpetrated in this way: the five persons named as the alleged fraudsters in paragraph 3 of the Cause used Kells as a vehicle, through the Luxembourg company which they collectively controlled, the Union International De Patrimmoine (UIP), to enrich themselves out of monies which the First Plaintiff had deposited in Kells' account Number 43713233 respectively on 25th November, 1997, 10th December, 1997 and 27th February, 1998, in the fraudulently induced belief (i) that he was the legal and beneficial owner of its shares and (ii) that he would receive a return of 8 per cent on the monies so deposited.

4. The Plaintiffs further allege that the matters set out in paragraphs 35 and 36 of the Cause amount to breaches of trust by Barclays (who were the third party to the freezing and disclosure order applications but who is now the Defendant and present applicant for discovery), inasmuch as the Bank knew or ought to have known of the fraudulent Scheme had it acted reasonably and made due and diligent enquiries into the transactions concerned. Nonetheless, and in breach of its duty (the Plaintiffs say) the Bank paid monies from Kells' account under a guarantee given by Kells

through its directors to secure loans made by Barclays to a company called Ivyside Limited, which at all material times was administered by UIP and of which three of the fraudsters were directors. The Plaintiffs therefore Claim appropriate declarations and the refund of Euros 7,372,618, being the equivalent of the sums in Deutschmarks which Barclays wrongfully debited to Kells' account in breach of their duties as constructive trustees and of care to the Plaintiffs. The foregoing is verified in more detail in the First Plaintiff's Affidavit sworn on 21st September, 1999, in support of the Application for the freezing and disclosure Orders.

5. The Court is now concerned with the Defendant's Application dated 7th January, 2003, which is in these terms:

> "[The Defendant applies]' "for an Order that the Plaintiffs do provide to the Defendant all documents in their possession, custody or control provided to the Plaintiffs by The Mercator Trust Company Limited or other companies connected with that company ('Mercator')."

6. I observe that Mercator features twice only in the main Cause, first in paragraph 12, in which it is alleged as a fact that it acted as Company Secretary to Kells in opening account Number 47313233. Secondly Mercator is mentioned as one of the entities in respect of whom Barclays should, if it had been acted honestly and reasonably, have made extensive enquiries from the Luxembourg police, who were already investigating the activities of two of the fraudsters, since it was a signatory, along with another two of the fraudsters, Mr. Rochelle and Mr. Brillaud, to Kells' account. Mercator also features in paragraphs 10 and 11 (c) of Mr. Hammerschmidt's Affidavit of September, 1999, in paragraph 5(ii) of his Affidavit of 30th January, 2003, made in opposition to the present Application, and is the addressee of the letter from his German lawyers forming Exhibit WRH 11 and written six days after Collas Day's letter to Barclays of 17th February, 1999. The letter before action did not follow until 23rd August,2002.

7. The letter from Boesebeck Droste (the German lawyers) sought extensive information regarding Kells, to which no reply was received notwithstanding that Messrs. Babbe Le Pelley Tostevin, Advocates in Guernsey, act for Mercator. However there are four letters from Mercator in the latter part of 1997 and early 1998 when they were in correspondence with Barclays regarding the opening of Deutschmark, U.S.Dollar, Swiss Franc and Sterling accounts for Kells, which are all exhibited to the Affidavit of Linda Kasch Bowers, the Bank's Compliance Manager, of 7th October, 1999. This was in response to the Bailiff's Disclosure Order of 27th September. On 18th December, 2002, Ozannes asked Collas Day for copies of the documents with which they had been provided by Mercator, but this request was rejected in Advocate Harris' letter of 31st December.

8. Correspondence between Ozannes and Collas Day on this subject ensued and on 28th February Advocate Ayres of Babbe Le Pelley Tostevin con- firmed to Advocate Harris that the papers already supplied to Collas Day (by inference containing references to Mercator) either belonged to Kells or were receivable by Mr. Hammerschmidt as a director of Kells. There were, however, other documents which Mr. Ayres said related to Kells belonging to Mercator, but which, again by inference, were not going to be disclosed to Collas Day. This letter was copied to Ozannes on 14th March, and this was followed up by a reply from them seeking to be provided with copies of the relevant documents pertaining to Mercator held by Collas Day. As I understand the situation it is the documents, comprising the first tranche mentioned in Advocate Ayres' letter, which Advocate Shepherd, representing Barclays, now submits should be discovered in compliance with his summons of 9th January.

9. Until the middle of 1999 discovery of documents in England was regulated by Order 24 of the Rules of the Supreme Court. Under Rules 1 and 2 there was provision for mutual discovery within fourteen days of the close of pleadings, though (by Rule 1(2)) the parties were entitled to agree to limit or dispense with such discovery. As the Court of Appeal pointed out in Van Leuven v. Nielsen *(infra)* there is no provision for automatic discovery in Guernsey as there then was in England. However, under Rule 3(1), which matches but is not identical with, the Guernsey Rule 39(1), the Court may order any party (meaning a party to the action before it at the time of the

application) to provide a list of the documents which are, or have been, in his possession, custody or power

> *".....relating to any matter in question in the cause or matter."*

This is slightly different wording to Rule 2(1) which specifies, as does our Rule 39(1), that the documents, a list of which is sought, should relate to

> *"……any matter in question between them in the action."*

10. The three kinds of discovery that previously existed in England are very helpfully listed at paragraph 2.54 of Matthews & Malek on Discovery [1992], and, although, in Victor Hanby Associates Ltd & Hanby v. Oliver [1990] Jersey Law Reports at page 349, the Jersey Court of Appeal indicated that the Royal Court was not necessarily bound by the practices which had developed in England during the latter part of the nineteenth and the early part of the twentieth centuries, and may develop its own practice, the Royal Court in Guernsey tends to follow the English practice as it was prior to the introduction of the new C.P.R's.

11. The Commentary to Order 24 Rule 3(1) of the Rules of the Supreme Court, in the 1999 White Book at paragraph 24/3/5, under the Heading 'Stage at which discovery may be ordered', indicates that while the Court has a wide discretion in the matter, it is generally not ordered before the issues have been defined by the pleadings, which does not ordinarily occur prior to the close of the pleadings. In the instant case, however, Mr. Shepherd submitted that it is necessary in the interests of justice and the saving of costs for the discovery sought to be ordered before the Defence is filed for two main reasons, namely:

(A) He cannot properly formulate his defence

(B) Unless the disclosure is made it will be extremely difficult to decide whether or not to join Mercator as a third party under Rule 33.

12. In developing his argument under head (A) Mr. Shepherd said that in the absence of the information contained in the letters, which are undoubtedly in the possession of Collas Day, he will be driven to filing a Defence which does little more than traverse the facts alleged in the Cause, for the reason that he will not possess the information necessary for him to file a comprehensive Defence. Once the issues are joined discovery will then inevitably follow, leading to a virtual certainty that amendments to the Defence will be sought (and probably resisted) which will in turn lead to higher costs. Accordingly, on the analogy of Rule 8 of the former Order 24, this is a step which should be taken now in the interests not only of disposing fairly of the cause but also of saving costs, especially if this is, correctly, regarded as an aspect of case management. The impact of the new C.P.R's on a case of this kind is fully covered in paragraphs 14 to 18 and 19(5) of Mr. Shepherd's Skeleton Argument.

13. In support of his contention Mr. Shepherd cited Van Leuven & others v. Nielsen [1993] GLJ Appeal No. 197 and R.H.M.Foods Ltd v. Bovril Ltd [1982] 1 AER 673. In the former Collins J.A. said, at page 300 of the Defendant's documents, letters E to F:

> "……'[Rule 39(1)] 'does not specify either that an order for discovery must be made or specify when it is to be made, and we find that in each case it is in the discretion of the Court to decide, first of all, whether to order discovery, and secondly, to decide the stage at which it shall be ordered. It is true to say that it will be most usual for discovery to be ordered after the close of pleadings, that is to say, after the entry of the case in the witness list." My emphasis.

14. I observe that in the Van Leuven case the discovery sought by the Plaintiff was ordered by the Royal Court after the Defence had been filed but prior to the fur- nishing of the further and better particulars which were also sought, and that leave to appeal against that order was refused by

the full Court of Appeal. In the R.H.M. Foods case, which was a passing off action between two large commercial companies, discovery had been ordered by Warner J. after the issue of the Writ and, concurrently, service of a motion for an interlocutory injunction to restrain the alleged passing off by means of television advertisements, but before delivery of the Statement of Claim. Lawton L.J said this at page 386h of the Bundle:

> "The need for definition of the issues probably explains why orders of the kind made by Warner J. are so rare. It is, I think, significant that the only case to which we were referred dealing with the making of an order for discovery before any pleading was delivered was Speyside Estate & Trust Co v. Wraymond Freeman (Blenders) Ltd [1949] 2 AER 796. In that case the purpose of the order was clearly to save costs' (as Mr. Shepherd submits here). 'It was not for the purpose as this application was, of fishing for evidence to support an allegation which it was submitted could be inferred from conclusions set out in affidavits."

Lawton L.J. then continued:

> "In my judgment, save in exceptional circumstances, orders of the kind under discussion in this case should not be made until the plaintiffs' case has been fully and properly pleaded in a statement of claim."

I fully understand that these remarks, and those of Oliver L.J. which followed, were in relation to that which was a novel application, and, as Oliver L.J. said at page 389c:

> "……..it is a startling proposition and one with very far-reaching consequences that a plaintiff has only to swear an affidavit affirming his belief that a defendant has been fraudulent to entitle him, before the case is ever pleaded, to a one-sided discovery of documents in aid of some application for interlocutory relief which desires to make. I do not say that there cannot be such a case, for the Court has wide power to order discovery where the justice of the case demands it."

A similar result occurred in the earlier case, which is included in the Defendant's bundle, of Gale v. Denman Picture Houses Ltd. [1930] 1 K.B 588 in which an order for discovery prior to the statement of claim being delivered was reversed on appeal, Scrutton L.J. remarking:

> "A plaintiff who issues a writ must be taken to know what his case is."

In the instant case, of course, there is no question of the First Plaintiff not having formulated his case by delivering an appropriate pleading.

15. Advocate Harris, on behalf of the Respondent Plaintiff, has submitted that the Application is not in proper form and lacks any reference to the appropriate Rule. He said the proper form is by way of an application for lists of documents as provided in Rule 39(1)(a). In my judgment there is some validity in this criticism. Although the Application of 7th January does not purport to be made under Rule 39, it is clearly intended to be an application for discovery, for in his Affidavit in support sworn two weeks later Advocate Shepherd so des-cribes it in the first sentence of the second paragraph. However an application for discovery must not be confused with a Notice to Produce, which in England was covered by Rules 4 and 5 of Order 27, and could require the opposite party to produce the documents specified in the notice at the trial. It was thus an *evidential* rule, which permitted the introduction of secondary evidence if the notice was not complied with.

16. As Advocate Harris has said, the proper application is that the opponent should provide lists of documents, as indeed Rule 39(1)(a) in terms requires. In England the list, whether it is under Rule 2 or in compliance with an Order under Rule 3, was required to be in Form 26 of Appendix 1 to R.S.C. appearing at page 33 of Volume 2 of the 1999 White Book. The Affidavit which accompanies it (See our Rule 39(1)(b)) had to be in Form 27. But there was no requirement that

the Application for discovery had to be supported by an affidavit, as has been done here: indeed the Commentary at paragraph 24/3/2, page 451 of Volume 1 indicates the contrary. Once discovery has been given there is then a right of inspection under Rule 40(a). The Application here uses the word 'provide', meaning 'provide (or 'produce') to the Defendant', for which there is no specific sanction. However, it seems to me that the proper course to adopt is to treat the Application as made in proper form for discovery of a list of the documents comprising the first tranche referred to in Advocate Ayres' letter of 28th February, so that the Court can go on to decide the essential question on which Counsel are really at issue, namely whether this application for specific discovery should be ordered before, or after, the Defence is filed.

17. However there is another hurdle to surmount, inasmuch as the application is not for general discovery such as that which in England would have been made under Rule 3(1) of Order 24. In that case an affidavit in support is required, as it is if the application is for that which has been described as further discovery, as in the Victor Hanby case (*supra)*, or for the initial discovery of a class of documents which, if made in England, would have been under Rule7(1), (in which case Rule 7(3) also required a supporting affidavit) as is the situation here. Under that Rule the Court was empowered to make an order at any time. It follows, in my view, that, as the Court of Appeal in Jersey said in the Victor Hanby case, it is open to the Royal Court to develop its own practice, this can be done in an application such as the one in the instant case. It may therefore, if it considers it in the interests of justice to do so, and that the order, if given, will facilitate the speedier disposal of the case, or, realistically, be likely to save costs, accede to an application for specific discovery of particular documents or of a class of documents. Having regard to these principles, then, should I grant the order which the Defendant seeks at this stage in the instant case?

18. In his Affidavit Advocate Shepherd sets out four reasons why this Application should succeed. They are first, that Barclays were not party to the alleged fraud but merely received the deposits and paid out the sums in question from Kells' account in the normal course of its business; that Kells was introduced to it as a customer by Mercator, the company secretary and corporate director of Kells, and that Barclays was entitled to rely on Mercator having carried out its duties with due diligence when introducing a customer, i.e. Kells, to the Bank. Clearly Mercator played a pivotal role in the early stages of the relationship.

19. Secondly, Mercator was the link between Kells and Ivyside, the fraudulent vehicle which facilitated the fraud and to which Mercator also provided corporate directors, and gave the relevant instructions to the Bank. Barclays knows not whether Mercator was, like the Bank, an innocent party sucked in to the scheme, or merely negligent. The discovery sought is necessary to ascertain these matters, and thence whether Mercator should be brought in as a third party at this stage. Thirdly, Mr. Shepherd makes the point to which I have already referred, namely that refusal of the Application will result in later costly amendments and further delay (in addition to that which, he says, has already been occasioned by the Plaintiff and his Advocates); finally the delay brought about by the discovery now sought will be unsubstantial, inasmuch as the documents are readily available, and that any such delay and inconvenience to the Plaintiff would be wholly outweighed by that occasioned if the Application is not granted.

20. In further support of his argument Mr. Shepherd relied on the third holding in Intel Corporation v. General Instrument Corporation [1989] (not 1999) F.S.R 640, which is in these terms:

> "Discovery of documents should not be given before defence unless it was desirable to avoid costs or to achieve a speedy and proper conclusion of the dispute."

This was an action for infringement of patent in which the defendants sought orders (1) that the plaintiff should provide further and better particulars, and an extension of time for the defence until after the particulars were given, and (2) discovery of documents relating to an application for a German patent, again before filing the defence. The first part of the application in the Intel case did

not therefore relate to discovery, but the judgment of Aldous J. thereon is of help as it indicates his reasoning regarding the saving of costs.

21. The application for further and better particulars to be given before defence in the Intel case arose because of the special situation in patent actions, inasmuch as Order 104, Rule 5(2) R.S.C. required the plaintiff to serve with his statement of claim particulars of the infringement relied on, showing which of the claims in the specification of the patent were allegedly infringed, and giving at least one instance of each such infringement. The plaintiffs had given particulars complying with the sub-Rule as regards the sixth and seventh defendants, but had failed to show specific acts of infringement individually alleged against the first five defendants. When the further particulars were given they contained an omnibus response as against the first five defendants. Aldous J. held that, though it was desirable that details of the actual acts of infringement should be given separately against each defendant, the defendants could nonetheless adequately plead to the statement of claim, and that the added expense occasioned by ordering them to plead to the statement of claim as it was, and then pleading individually on behalf of the sixth and seventh defendants if this became necessary, in relation to the overall cost of the issues at the trial, (which would be principally as to the validity of the patent) would be small in relation to the whole of the costs. He therefore declined to order the particulars in advance of the defence.

22. The second part of the application in the Intel case sought, as in this case, an order for specific discovery under Rule 7(1), so as to ascertain the grounds of invalidity advanced in relation to an application for a German patent in respect of the same invention as was in issue in the English case, prior to the defence. That application had been withdrawn and the German Patent Office file had been destroyed, so that the only way the defendants could ascertain the grounds of invalidity put forward in Germany was by discovery from the plain- tiffs. The defendants submitted that the discovery would enable them to select only those grounds of invalidity which they regarded as material to plead in the English action, and thus save the costs that would be occasioned by pleading the immaterial grounds.

23. Throughout the judgment Aldous J. referred to the principles of discovery contained in Order 24, and so I do not regard that decision as only referable to a special situation which might be regarded as arising under the Patents legislation. Nevertheless in order fully to understand the decision it is necessary briefly to digress into the realms of patent law. This is almost exclusively contained in the Patents Acts 1949 and 1977. Under those Acts patents are regarded as 'valid' and 'invalid' respectively. Under the 1949 Act an 'old' patent may be revoked on the application of an interested party and under the 1977 Act a 'new' patent may be revoked on the application of any person. An in- valid patent is one that may be so revoked and a valid one is one which may not.

24. The fourteen grounds on which a contention of invalidity can be based in the case of an old patent are listed at paragraph 461 of Halsbury's Laws of England 4th Edition Volume 35, and the nine grounds of invalidity in respect of a new patent are shown at paragraph 567 of the same Volume. Under section 74(1)(a) of the 1977 Act the validity of a patent may be put in issue, *inter alia,* by way of defence in infringement proceedings, which is what was being done in the Intel case. Equally, if a party to such an action challenges its validity he was required by R.S.C.106 Rule 6(1A), to serve with his defence particulars of the objections on which he relied.

25. As there were two lines of authority, one to the effect that discovery in a patent action is limited to documents relevant to the matters in issue on the pleadings, and the other that discovery might be ordered if it could assist a party in formulating an allegation of invalidity, the Court's decision would have the effect of resolving that conflict on an important point of principle. As regards the discovery part of the application Aldous J. said at p. 647:

> "I have come to the conclusion that the proper course to take is to refuse to order discovery of the German documents at this stage and to leave the matter to be raised later if necessary. Firstly, there does not appear to me to be any necessity of deciding the point of principle at the moment. If the documents are dicover- erable now, then I believe they must be discoverable at the normal time. The

> issue between the parties will be the same whether or not the defendants have pleaded and whether or not the defendants' pleading raises the same grounds of invalidity as that raised in Germany."

He continued at p. 648:

> "Fourthly, the only saving in costs by ordering discovery now would be to enable the defendants to plead at this stage grounds of invalidity which are not known to them and which were raised in the German documents. The costs of amending to add such grounds will be small when considered against the background of the case as a whole."

Aldous J. ended by saying that he did not consider there was any special reason for ordering discovery before defence as regards the saving of costs, which, of course, Mr. Shepherd submitted has been shown in the instant case.

26. Turning to the Cause the averments here may be divided into four main areas, namely contravention of The Security Interests (Guernsey) Law 1993 in relation to Barclays' security interests (paragraph 31); Barclays' knowledge of the fraud (paragraphs 33 and 34); Barclays' wrongful receipt of trust property with knowledge of the alleged breach of trust (paragraphs 35 and 36) and Barclays' breach of its mandate with Kells (paragraph 38). It seems to me, as regards head (A) of Mr. Shepherd's submissions, that the Defendant can adequately plead to those averments, and to the facts allegedly supporting them in the body of the Cause without the discovery of the first tranche of the documents concerned. It is implicit from Aldous J.'s decision that it is not permissible to use the process of discovery to construct a case for alleging the invalidity of the patent, and equally, here, it is not, in my view, a legitimate exercise of the process to construct the case for the defence. In short, I do not consider that the discovery sought is necessary for saving costs, or for the fair disposal of the action.

27. Coming to head (B) the same can be said, in my judgment, for the issue of a third party notice against Mercator. As I have remarked earlier, Barclays are already in possession of the correspondence passing between it and Mercator relating to the opening of Kells' various accounts, for these are exhibited to the Affidavit of M/s Bowers. The disclosure of the first tranche may, it is true, add some detail to that, possibly requiring amendment. As I have also just said, discovery is not a process which should be used for the purpose of constructing a case against a party.

28. I do not necessarily say, as Mr. Harris did, that the present Application is a fishing expedition in the hope (as Mustill L.J. said in Berkeley Administration Inc. v. McClelland [1990] F.S.R at page 383] 'that something useful will turn up'. But the examination of the authorities which I have endeavoured to undertake indicates that in this case the normal rule, as reinforced by the passages at paragraphs 2.55 of Matthews & Malek on Discovery and 2.61 of the same authors' later work 'Disclosure', that the issues should be defined by the pleadings before discovery is ordered, should prevail, for the reasons that in my judgment the Defendant can adequately formulate its Defence in the main action, and has sufficient existing material to issue proceedings against Mercator should it be so advised.

29. It follows that I dismiss the Defendant's Application dated 7th January, 2003. I am minded to reserve the costs hereof, but I will hear argument if Counsel so wish.

A.R.W.Hancox
Lieutenant Bailiff
23rd May 2003.

