

## **IMPLEMENTING THE THIRD MONEY LAUNDERING DIRECTIVE:**

### **DRAFT MONEY LAUNDERING REGULATIONS 2007**

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#### **OPINION**

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1. We are asked to advise the Law Society on the human rights and constitutional issues arising from the apparent lack of certainty in the proposed implementation of the Third Money Laundering Directive. Specifically, a lack of legal certainty in the definition of “beneficial owner” in the Draft Money Laundering Regulations 2007 (the draft regulations) has been identified by practitioners specialising in trust law<sup>1</sup> and we are asked to comment on the human rights and constitutional implications of this uncertainty.

#### **Legislative framework and pre-legislative consultation**

2. The Third Money Laundering Directive 2005/60/EC (3MLD) was adopted in October 2005 (under the UK’s Presidency of the EU) and entered into force on 15 December 2005. HM Treasury (HMT) is considering how to implement it before the two year deadline expires in December 2007. In July 2006, HMT issued “Implementing the Third Money Laundering Directive: a consultation document”. The Law Society, amongst others, was concerned, in particular, about the application of the term “beneficial owner” to trusts and raised its concerns in its official (public) response to the consultation.
3. In January 2007, HMT issued a further consultation document “Implementing the Third Money Laundering Directive: Draft Money Laundering Regulations 2007”. The draft regulations do not, however, alleviate the Law Society’s concerns about the definition of “beneficial owner”. Specifically the definition in Article 3(6) of

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<sup>1</sup> See e.g. the opinion of Nicholas Green QC and Nicholas Le Poidevin on 3MLD (15 Jan 2007) published on the Society of Trust and Estate Practitioners’ website (the STEP opinion): <http://www.step.org/attach.pl/1778/3224/SDOC4448.pdf>

3MLD is directly adopted by draft regulations 2(2) to (4). HMT have been unwilling to expand on the core definition to provide greater clarity, contending that industry-led guidance can resolve the uncertainty:

“2.23 A number of consultation responses from legal professionals expressed concern about the impact of the requirement in the Directive to identify and take risk-based and adequate measures to verify the identity of the beneficial owner. Representations were made that the Regulations should explicitly state what measures were needed and when they should apply.

2.24 The previous consultation document set out in detail the Directive’s requirements and the definition of beneficial ownership. The Government considers that it is unhelpful to provide in the draft Regulations different expectations for each possible situation. The Government expects supervisors or industry to develop guidance on what measures can and should be undertaken to meet the requirements imposed to ascertain the beneficial owner. The Government will work closely with these bodies to ensure that the requirements and any subsequent guidance are as helpful as possible.”<sup>2</sup>

3. The definition of “beneficial owner” in 3MLD and the draft regulations is central to the requirement of customer due diligence (CDD) imposed by 3MLD and the draft regulations. CDD measures are set out in draft regulation 4 and consist broadly of:

- identifying the customer and verifying the customer’s identity;
- identifying the beneficial owner and taking risk-based and adequate measures to verify his identity, so that whoever is doing the CDD knows who the beneficial owner is, including (where trusts are concerned) measures to understand the ownership and control structure of the customer;
- obtaining information about the purpose and nature of the business relationship; and
- ongoing monitoring.

4. The definition of “beneficial owner” is contained in regulations 2(2) to (4):

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<sup>2</sup> *Implementing the Third Money Laundering Directive: Draft Money Laundering Regulations 2007* at paras. 2.23 - 2.24.

*(2) Subject to paragraphs (3) and (4), “beneficial owner” means the individual who ultimately owns or controls the customer or on whose behalf a transaction or activity is being conducted.*

*(3) In the case of a body corporate, the beneficial owner includes any individual who-*

*(a) ultimately owns or controls (whether through direct or indirect ownership or control, including through bearer share holdings) more than 25% of the shares or voting rights in the body other than a company listed on a regulated market which is subject to disclosure requirements consistent with Community legislation or equivalent international standards;*

*or*

*(b) otherwise exercises control over the management of the body.*

*(4) In the case of a legal entity or a legal arrangement (such as a trust) which administers and distributes funds, the beneficial owner includes-*

*(a) where the beneficiaries have been determined, an individual who is the beneficiary of at least 25% of the property of the entity or arrangement;*

*(b) where the beneficiaries have not yet been determined, the class of persons in whose main interest the entity or arrangement is set up or operates;*

*(c) an individual who controls at least 25% of the property of the entity or arrangement.*

5. A person who fails to comply with any associated requirement in regulations 7, 8, 10 to 16 or 27 will be guilty of a criminal offence (by regulation 41). The offences are serious. Regulations 11(5) and 14(1)(b), for example, create two new requirements for relevant persons to pay special attention to threats, products and activities which may carry a higher risk of being related to money laundering or terrorist financing. Breach of these requirements is a criminal offence and with a maximum sentence, on conviction on indictment, of 2 years’ imprisonment and/or a fine (regulation 41). Obviously a legal professional convicted of any serious criminal offence under the draft regulations potentially faces loss of liberty and livelihood.

### **“Beneficial owner” – a summary of the uncertainties**

6. The following areas of uncertainty have been identified by various professional bodies and experts in trust law:

- Does “beneficial owner” apply in the case of bare trusts, which include trusts arising in the case of joint ownership of property? Does the definition apply to the majority of trustees who are not the beneficial owners? Does it apply to beneficiaries who will ultimately not become the beneficial owner in legal terms?
- Which type of trusts (whether express, implied, constructive or resulting) does “legal entity or a legal arrangement” include? What about those arising on succession from joint ownership of property? Does it extend to pension or charitable trusts?
- The operation in practice of the phrase “25% beneficial interest” in a variety of contexts: e.g. Are those with powers of appointment, reserve powers or powers of protection properly to be considered the controller? How, in practice, are those investors in a private equity fund with a 25%+ beneficial interest to be determined?<sup>3</sup>
- The operation of “beneficial ownership” test in companies, pension schemes and private equity and other funds.<sup>4</sup>
- The operation of “beneficial owner” as regards successive interests.<sup>5</sup>
- The operation of “beneficial owner” as regards contingent interests.<sup>6</sup>
- The operation of “beneficial owner” as regards discretionary trusts.<sup>7</sup>

7. In summary, the experts in trust law agree that the uncertainty in the definition of beneficial owner in 3MLD and the draft regulations is *inherent in the definition*

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<sup>3</sup> Appendix to a letter from the President of the Law Society to the Chief Secretary to the Treasury, 11 Jan 2007 at examples 2.1 to 2.3.

<sup>4</sup> *Implementing the Third Money Laundering Directive, The Law Society’s Response* (October 2006) at sections 2 and 3 respectively. Similar concerns have been voiced by a number of City firms in this regard: see e.g. <http://business.timesonline.co.uk/tol/business/law/article1543060.ece>

<sup>5</sup> Appendix to a letter from the President of the Law Society to the Chief Secretary to the Treasury, 11 Jan 2007 at example 1. See also [www.moneylaundering.lawsociety.org.uk](http://www.moneylaundering.lawsociety.org.uk)

<sup>6</sup> *ibid.* at example 2.

<sup>7</sup> *ibid.* at example 3. Each of these examples is considered in detail in the STEP opinion at paras. 12 – 28.

*itself* and creates ambiguity in a wide range of commonplace situations. The two principal difficulties have been summarised as flowing from<sup>8</sup>: (1) the fundamental difference between the concept of ownership in a civil law system<sup>9</sup> and the (apparently) same concept in a common law system (including for this purpose Equity); (2) in most trusts, it will in practice be impossible to identify the beneficiary or beneficiaries satisfying this test (of course the trust is a legal concept uniquely created by the English law principles of Equity)<sup>10</sup>.

8. As the STEP opinion concludes, “a more detailed definition is required ... because a mirror-image transposition [of 3MLD into the draft regulations] simply will not address all of the myriad complications which arise in English trust law”. Ironically, the 9<sup>th</sup> recital in the preamble to the 3MLD, identifies greater precision in the definition of “beneficial owner” as one of its key purposes:

(9) Directive 91/308/EEC, though imposing a customer identification obligation, contained relatively little detail on the relevant procedures. In view of the crucial importance of this aspect of the prevention of money laundering and terrorist financing, it is appropriate, in accordance with the new international standards, to introduce more specific and detailed provisions relating to the identification of the customer and of any beneficial owner and the verification of their identity. To that end a precise definition of ‘beneficial owner’ is essential. Where the individual beneficiaries of a legal entity or arrangement such as a foundation or trust are yet to be determined, and it is therefore impossible to identify an individual as the beneficial owner, it would suffice to identify the class of persons intended to be the beneficiaries of the foundation or trust. This requirement should not include the identification of the individuals within that class of persons. (emphasis added).

9. Whilst that may explain, in part, why HMT are not prepared to define further the term, it does not in any way ameliorate the serious difficulties with the content of the definition. It is not the intention to achieve greater precision which matters, but the clarity in the resulting definition itself.

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<sup>8</sup><http://www.step.org/attach.pl/1778/3222/STEP%20response%20to%20HMT%20on%203AMLD%20implementation.pdf> (STEP’s response to the implementation of 3MLD at pt1, p1.).

<sup>9</sup> applicable in nearly all other States/systems except England and Wales, Ireland, Gibraltar, and to some extent Cyprus.

<sup>10</sup> The development of English trust law and the contrast with other European systems is considered in STEP’s response to the implementation of 3MLD at pt1, p2ff.

## **Legal certainty: constitutional and human rights principles as applied to the draft regulations**

10. The requirements of legal certainty as regards criminal offences derive from three separate (but overlapping) legal sources: Community law, common law and human rights law. Each imposes similar standards.
11. At the outset it is important to stress the constitutional importance of legal certainty, particularly as it applies to criminal offences. As Lord Diplock in *Black-Clawson*<sup>11</sup> observed:

“The acceptance of the rule of law as a constitutional principle requires that a citizen, before committing himself to any course of action, should be able to know in advance what are the legal consequences that will flow from it.”

### *Community law*

12. Legal certainty is itself a core principle of EU law:

“[T]he Court [the ECJ] has consistently held ... that the principles of legal certainty and the protection of individuals require, in areas covered by Community law, that the Member States’ legal rules should be worded unequivocally so as to give the persons concerned a clear and precise understanding of their rights and obligations and enable national courts to ensure that those rights and obligations are observed.”<sup>12</sup>

13. Legal certainty requires that the *effect* of Community legislation must be clear and predictable.<sup>13</sup> Resulting obligations imposed on individuals must be clear and understandable and ambiguities arising from the language of the law should be resolved in favour of the individual.<sup>14</sup> Thus Community law provides that:

“[A] penalty, even of a non-criminal nature, cannot be imposed unless it rests on a clear and unambiguous legal basis.”<sup>15</sup>

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<sup>11</sup> *Black-Clawson International Ltd. v. Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591, at 638.

<sup>12</sup> Case 257/86 *Commission v. Italy* [1988] ECR 3249, para. 12. See e.g. paras. 31 – 38 of the STEP opinion.

<sup>13</sup> Cases 212-217/80 *Salumi* [1981] ECR 2735 at para. 10.

<sup>14</sup> Case 169/80 *Administration des Douanes v. Gondrand Frères* [1981] ECR 1931, paras. 17-18.

<sup>15</sup> *Commission v. Italy* (op cit.).

14. This principle in turn requires legal certainty in any domestic legislation governed by Community law. “According to established case law, in areas covered by Community law, national rules should be worded unequivocally so as to give the persons concerned a clear and precise understanding of their rights and obligations and enable national courts to ensure that those rights and obligations are observed ... A requirement to which the case law attaches particular importance is that rights flowing from directives must be unequivocally stated so that citizens have a clear and precise understanding of them”.<sup>16</sup>

15. The Community law requirements of legal certainty have been applied by the ECJ to require Member States to implement Community Directives with greater precision at the national level.<sup>17</sup> Those cases do not, however, in our view, imply that Member States will necessarily have achieved the requisite level of legal certainty at the national level merely because they have directly transposed or imported a core definition contained in a Directive into national law. Indeed the European cases may be said to underscore the need for the national authorities to provide greater clarity in the implementing legislation where it is lacking in the European legislation itself. Similarly, as the STEP opinion notes, where the Directive itself is under challenge for ambiguity, the appropriate remedy is greater clarity in the domestic implementing legislation, rather than annulment of the Directive itself.<sup>18</sup> Clearly, the use of abstract terms in Community legislation does not render *per se* the provision in question incompatible with the principle of legal certainty<sup>19</sup>, particularly where the Directive itself provides some guidelines for the application of such terms. However, as the leading work notes:

“Examples of situations which might be held to be contrary to legal certainty are the following: where a provision is wholly meaningless or manifestly irreconcilable with other provisions of the same measure; where a situation is governed by a thicket of successive inter-related rules of primary, secondary

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<sup>16</sup> Tridimas, *The General Principles of EU Law* (2<sup>nd</sup> ed.) at p.246, citing: Case 29/84 *Commission v. Germany* [1985] ECR 1661; Case 143/83 *Commission v. Denmark* [1985] ECR 427; Case 363/85 *Commission v. Italy* [1987] ECR 1733; Case C-120/88 *Commission v. Italy* [1991] ECR I-621; Case C-119/92 *Commission v. Italy* [1994] ECR I-393.

<sup>17</sup> See e.g. the cases cited at fn 29 of the STEP opinion.

<sup>18</sup> STEP opinion at fn31: Case C-214/03 *France v. Parliament and Council* [2005] ECR I-0000, Opinion of Adv. Gen. Geelhoed quoting Case C-377/98 *Netherlands v. Parliament and Council* [2001] ECR I-7079, paras. 87-88. Quoting Opinion of Adv. Gen. Jacobs at 7110.

<sup>19</sup> Case C-377/98 *Netherlands v. Parliament and Council* [2001] ECR I-7079.

and judge made law so as to make it manifestly impossible for the citizen to know the rules and the courts to apply them...”<sup>20</sup>

16. In our view, if the draft regulations as presently formulated were left to be clarified by a mixture of professional and industry guidance, there is a significant risk that they would form exactly the sort of example given by Professor Tridimas above. An insuperable constitutional problem would be created: if the ECJ, in an appropriate case, recognises the uncertainty in 3MLD<sup>21</sup>, it is nevertheless likely to hold that this can be rectified by definitional clarity at the national level rather than annulling the Directive – particularly when the effect of the definitional uncertainty is linked to its interaction with and application to English (trust) law. However, self-evidently, the draft regulations themselves do not provide any greater clarity at the national level since they merely replicate the ambiguous definition in 3MLD and leave the rest to guidance from professional bodies. For the reasons we explain below, it is not possible to delegate the content and breadth of a criminal offence in this way.

17. Accordingly, we are of the firm view that the regulations as currently formulated are open to challenge on grounds of lack of legal certainty. Even if the ECJ considers that 3MLD is sufficiently precise at the European level, as we note above, that does not obviate the need for Member States to implement the 3MLD with sufficient precision so that its citizens can know in advance with sufficient certainty the ambit of the associated criminal offence. Plainly the draft regulations do not do that. Given the unique features of English trust law, there is a national obligation to expand upon the 3MLD definition to ensure the resulting criminal offence is sufficient clear and precise. Thus, whilst a domestic court considering any challenge on grounds of legal certainty might wish to await the

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<sup>20</sup> Tridimas, *The General Principles of EU Law* (op cit.) at pp245-6 (footnotes omitted).

<sup>21</sup> Judgment is awaited from the ECJ in a challenge by the Belgian bar to the Second Money Laundering Directive (2MLD - which led to the Proceeds of Crime Act 2002). The applicants allege that 2MLD violates Art. 6 ECHR by failing adequately to respect legal professional privilege since the obligation to report suspicious transactions then deprives the client of the services of his lawyer: Case C-305/05 *Ordre des barreaux francophones et germanophone and others v. Conseil des Ministres*. Adv. Gen. Maduro’s opinion (14 Dec 2006) is that 2MLD is valid providing it is interpreted in accordance with the 17<sup>th</sup> recital in the preamble to 2MLD (which was considered in *Bowman v. Fels* (op cit.) and is identical to the 20<sup>th</sup> recital of 3MLD). The Adv. Gen. also noted (at para. 21) that “Directive 91/308 [1MLD] was recently repealed by Directive 2005/60 [3MLD]. The content of that directive reproduces without amendment the provisions put in issue in this case.”

outcome in the ECJ, in either event, in our view, the draft regulations are open to challenge on grounds of unacceptable vagueness.

18. Another of the general principles of Community law is respect for fundamental human rights and the ECJ frequently has regard to the requirements of the European Convention on Human Rights (ECHR). A penalty imposed by a Member State in respect of a breach of an obligation deriving from Community law must respect the fundamental rights and principles in the Community legal order, including the rights and principles to be found in the ECHR.<sup>22</sup> These are considered below and are broadly analogous to the Community law requirements of legal certainty.

19. Furthermore, although Article 39 of 3MLD requires that the UK penalise any infringements of 3MLD in order to enforce the Directive, Article 39 does not require that the UK criminalise them. Accordingly, since the UK has *chosen* to attach criminal sanctions to infringements of 3MLD, any attempt to enforce such penalties must also comply with fundamental principles of statutory interpretation in the common law. Thus Community law does not, in any way, supplant the common law requirements of legal certainty, which are also considered below. They too broadly resemble the Community law requirements of legal certainty.

### *Common law*

20. Any criminal offence-creating provision should, as a matter of principle, be construed narrowly.<sup>23</sup> “It is a principle of legal policy that a person should not be penalised except under clear law” (the principle against “doubtful penalisation”)<sup>24</sup>. As Lord Diplock explained in *Fothergill v. Monarch Airlines Ltd* [1981] AC 251 at 279:

“Elementary justice or, to use the concept often cited by the European court, the need for legal certainty demands that the rules by which the citizen is to be

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<sup>22</sup> Case 77/81 *Zuckerfabrik Franken* [1982] ECR 681 paras. 17-29; Case 5/89 *Wachauf* [1989] ECR 2638 paras. 17-19; Case C-260/89 *ERT* [1991] ECR I-2925 paras. 41-42.

<sup>23</sup> See e.g. *R v. Moran* [2002] 1 WLR 253 at para.7; *Sweet v. Parsley* [1970] AC 132 at 149.

<sup>24</sup> See e.g. Bennion, *Statutory Interpretation* (4<sup>th</sup> ed.) at section 271.

bound should be ascertainable by him (or more realistically by a competent lawyer advising him) by reference to identifiable sources that are publicly accessible.”

21. Likewise, in *Warner v. Metropolitan Police Commissioner* [1969] 2 AC 256, 296, Lord Morris of Borth-y-Gest stated: “In criminal matters it is important to have clarity and certainty” and in *Fawcett Properties Ltd. v. Buckingham County Council* [1961] AC 636 at 662 Lord Cohen said that the principle that “a man is not to be put in peril upon an uncertainty ... involves that if a statutory provision is ambiguous, the court should adopt any reasonable interpretation which would avoid the penalty”. Thus, for example, significant doubts as to the precise scope of a legal prohibition have been found to afford a defence in criminal proceedings where the conduct in question has fallen within the penumbra of uncertainty surrounding a particular byelaw.<sup>25</sup>

22. Lord Bingham recently summarised the effect of the common law in *R v. Rimmington* [2006] 1 AC 459 at para. 33:

“There are two guiding principles: no one should be punished under a law unless it is sufficiently clear and certain to enable him to know what conduct is forbidden before he does it; and no one should be punished for any act which was not clearly and ascertainably punishable when the act was done.”

23. The test applied by the House of Lords in *Rimmington* was essentially; (a) Was the offence clear, precise, adequately defined and based on a discernible rational principle? and (b) Would a legal adviser asked to give his opinion in advance be able to do so with confidence ?

24. In our opinion, as the views of the various legal advisers specialising in trust law make plain, given the “myriad complications which arise in English trust law”, the definition of “beneficial owner” in the draft regulations is so inadequate as to create real uncertainty in the ambit of the associated criminal offences. Lawyers, even those experienced in the relevant field, could not advise with confidence when the onerous anti-money laundering obligations will apply in a variety of commonplace situations and the legislation therefore, in our view, fails to satisfy Lord Bingham’s test. In short, the definition which has been imported into the

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<sup>25</sup> See e.g. *Bugg v. DPP* [1993] QB 473. c.f. *Percy v. Hall* [1997] QB 924 and the other byelaw cases in Emmerson and Ashworth, *Human Rights and Criminal Justice* (2001 ed.) at paras. 10-08 to 10-11.

draft regulations creates associated criminal offences which do not satisfy the common law requirements of certainty.

25. The constitutional requirement of certainty includes the principle of maximum certainty and the principle of strict construction of criminal statutes. Despite the various strong statements of principle, they have not been applied entirely uniformly by the English criminal courts.<sup>26</sup> However, the principles now have a stronger foundation by the operation of section 6 of the Human Rights Act 1998 and Article 7 of the ECHR, which is set out in Sch. 1 to that Act (considered below).

### *ECHR*

26. The concept of legal certainty runs throughout the Convention, playing a role, for example, in determining whether interference with the qualified rights under Articles 8 to 11 is “prescribed by law”. So far as the criminal law is concerned, Article 7(1) provides:

“No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed.”

27. In summary, Article 7 and the associated Strasbourg jurisprudence requires that the scope of criminal sanctions ought to be amenable to a reasonable level of legal certainty, with clarification provided by the Courts where necessary: see e.g. *Kokkanis v. Greece* (1992) 17 EHRR 397, at para. 52; *Brumarescu v. Romania* (2001) 33 EHRR 35, at para. 61. Whilst the principle enables Contracting States to regulate themselves “with reference to the norms prevailing in the society in which they live”, the law must be adequately accessible, an individual must have an indication of the legal rules applicable in a given case and he must be able to foresee the consequences of his actions, in particular to be able to avoid incurring

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<sup>26</sup> See further Ashworth, *Principles of Criminal Law* (5<sup>th</sup> ed.), pp.68-83.

the sanction of the criminal law: *SW and CR v. United Kingdom* (1995) 21 EHRR 363, at paras. 33 - 35.

28. The concept is deeply ingrained in the constitutions of other jurisdictions.<sup>27</sup> Likewise, international human rights law provides, for example, in Article 15 of the International Covenant on Civil and Political Rights and in Article 22.2 of the Rome Statute of the International Criminal Court, comparable requirements of legal certainty as regards criminal offences.
29. In *Rimmington*, at para. 35, Lord Bingham reviewed the Strasbourg jurisprudence on this topic, which he considered had been “clear and consistent”:

“The starting point is the old rule *nullum crimen, nulla poena sine lege* (*Kokkinakis v. Greece* (1993) 17 EHRR 397, para 52; *SW and CR v. United Kingdom* (1995) 21 EHRR 363, para 35/33): only the law can define a crime and prescribe a penalty. An offence must be clearly defined in law (*SW and CR v. United Kingdom*), and a norm cannot be regarded as a law unless it is formulated with sufficient precision to enable the citizen to foresee, if need be with appropriate advice, the consequences which a given course of conduct may entail (*Sunday Times v. United Kingdom* (1979) 2 EHRR 245, para 49; *G v. Federal Republic of Germany* (1989) 60 DR 256, 261, para 1; *SW and CR v. United Kingdom*, para 34/32). It is accepted that absolute certainty is unattainable, and might entail excessive rigidity since the law must be able to keep pace with changing circumstances, some degree of vagueness is inevitable and development of the law is a recognised feature of common law courts (*Sunday Times v. United Kingdom*, para 49; *X Ltd and Y v. United Kingdom* (1982) 28 DR 77, 81, para 9; *SW and CR v. United Kingdom*, para 36/34). But the law-making function of the courts must remain within reasonable limits (*X Ltd and Y v. United Kingdom*, para 9). Article 7 precludes the punishment of acts not previously punishable, and existing offences may not be extended to cover facts which did not previously constitute a criminal offence (*ibid.*). The law may be clarified and adapted to new circumstances which can reasonably be brought under the original concept of the offence (*X Ltd and Y v. United Kingdom*, para 9; *G v. Federal Republic of Germany*, pp 261-262). But any development must be consistent with the essence of the offence and be reasonably foreseeable (*SW and CR v. United Kingdom*, para 36/34), and the criminal law must not be extensively construed to the detriment of an accused, for instance by analogy (*Kokkinakis v. Greece*, para 52).”

30. It has been suggested by Emmerson and Ashworth, *Human Rights and Criminal Justice* (2001) para. 10-23 that:

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<sup>27</sup> Examples from the United States, Canada, South Africa and other jurisdictions are considered in Emmerson and Ashworth (op cit.) at paras. 10-17 to 10-22.

“the standard of certainty required under the Convention, and under comparable constitutional principles, is not a particularly exacting one.”

31. It is true that whilst a number of decisions since the Human Rights Act have considered the certainty requirements of Article 7, most have been concerned with whether the definition of the offence is sufficiently precise and the proper limits to the judicial development of the elements of offences remains somewhat unclear. In our view, it is fair to say that the “gradual clarification” of rules of criminal liability has been interpreted generously in the case law.<sup>28</sup>
32. Thus, in *Handyside v. UK* (1974) 17 YB 228 at 290, concerning the definition of obscenity in the Obscene Publications Acts 1959 to 1964, the Commission held that it was sufficient for Article 7 purposes if the legislation provided a general description which was then interpreted and applied by the courts.
33. In *SW and CR v. UK* (*op cit.*), the Strasbourg Court held (in a much criticised decision<sup>29</sup>) that the removal of the marital rape exemption by the House of Lords (see *R v. R* [1992] AC 599) did not amount to a retrospective change in the elements of the offence. Article 7 allows for “gradual clarification” of the rules of criminal liability through judicial interpretation from case to case, provided the resultant development is consistent with the essence of the offence and could reasonably be foreseen. See also *R v. C* [2004] 2 Cr App R 15.
34. In relation to statutory offences, however clearly drafted a provision may be, there is an inevitable need for some judicial interpretation, and in particular the need for elucidation of doubtful points and for adaptation to changing circumstances: *EK v. Turkey* (2002) 35 EHRR 41.
35. As regards the interpretation of Article 7 by the national courts since the enacting of the Human Rights Act, the requirements of legal certainty were found to be met in *R v. Pattni* [2001] Crim LR 570 (cheating the public revenue); *R v. Muhamad* [2003] QB 1031 (materially contributing to, or increasing the extent of, insolvency by gambling contrary to the Insolvency Act 1986, s.362(1)(a)); *R v. Misra and Srivastava* [2005] 1 Cr App R 21 (common law gross negligence

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<sup>28</sup> See e.g. *R v. Cotter, Clair and Wynn* [2002] 2 Cr App R 29.

<sup>29</sup> See Emmerson and Ashworth (*op cit.*) at 10-28 to 10-29.

manslaughter) and *R v. Rimmington*; *R v. Goldstein* (cited above) (causing a public nuisance).

36. Nevertheless, we remain of the view that the inherent uncertainty in the definition of “beneficial owner” creates an unprecedented situation so far as the possible ambit of a criminal offence is concerned. The sheer range of situations (which does not purport to be exhaustive) in which lawyers specialising in trust law have indicated their inability to advise with confidence as to whether the corresponding due diligence requirements apply creates a degree of uncertainty which, in our view, is of a different order from the cases considered above. In our view, the large number of commonplace situations in which there would be genuine uncertainty – even after expert legal advice – as to the operation of the draft regulations renders the offence as presently drafted unworkable and incompatible with Article 7.

37. Section 3 of the Human Rights Act contains a powerful interpretative obligation<sup>30</sup> and requires criminal offences to be construed compatibly with Article 7, “so far as possible”. This reinforces the common law principle of the restrictive interpretation of a criminal offence, considered above. In our view, however, it would be beyond the outer limits of s.3 to hold that the draft regulations do not apply to *any* of the areas of ambiguity identified to date, thereby reducing the legal uncertainty to an acceptable level. Plainly that would render the offence unworkable since large areas of trust law would be completely unregulated so far as anti-money laundering was concerned and the UK would inevitably be in breach of its Community law obligations to implement 3MLD. The robust application of s.3 in *R v. A. (No. 2)*<sup>31</sup>, for example, still resulted in a clearly defined offence, even if it was one which was not immediately apparent from the most literal reading of the statute or Parliament’s discernible intent (which can be secondary to s.3 in any event). Such an approach would not be possible here. What is required is a detailed definition of the term as it applies in trust law: no amount of “reading down” of the term can rectify that sort of definitional deficiency. Unlike primary legislation, in respect of which at most a declaration

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<sup>30</sup> The leading case on s.3 is now *Ghaidan v. Godin-Mendoza* [2004] 2 AC 557.

<sup>31</sup> [2002] 1 AC 45, HL.

of incompatibility may be made, secondary legislation such as the draft regulations can be disapplied by the Court if it is not possible to read it compatibly with the Convention: sections 3 to 4 and 6 to 8 of the Human Rights Act.

38. It is also important to note that the need for a clear definition is heightened when the criminal sanction has the capacity to limit the extent to which a person can consult freely with his lawyer.<sup>32</sup> Any criminal offence which (quite properly) impinges in any way upon a lawyer's confidential and privileged relationship with his client must necessarily be precisely and narrowly defined.<sup>33</sup> It is our view that the Court of Appeal's robust *dicta* in *Bowman v. Fels* [2005] 1 WLR 3083<sup>34</sup> and its strict interpretation of the Proceeds of Crime Act 2002 and the associated money laundering Directive which it sought to implement, strongly support such an approach. As the Court of Appeal noted at para. 74:

“...access to legal advice on a private and confidential basis is also a fundamental principle not lightly to be interfered with. This is so both in the criminal law sphere (*c.f. S v. Switzerland* (1991) 14 EHRR 670, *Öcalan v. Turkey* (2003) 37 EHRR 10 and *Campbell v. UK* (1992) 15 EHRR 137)...”

39. The Court of Appeal also endorsed the importance attached to the confidentiality of client-lawyer communications in the case law of the European Community<sup>35</sup> and strongly approved of the high constitutional status of legal professional privilege<sup>36</sup> as stated by Lord Taylor CJ in *R v Derby Magistrates' Court ex p B* [1996] 1 AC 487 at pp 503-508:

“It is a fundamental condition on which the administration of justice as a whole rests.”

and Lord Scott in *Three Rivers DC v Bank of England (No 6)* [2005] 1 AC 610, at para. 34: part of the “rule of law rationale”.

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<sup>32</sup> Having regard to the 20<sup>th</sup> recital in the preamble to 3MLD.

<sup>33</sup> Regulation 7 of the Money Laundering Regulations 2003 included a specific reference to the exemption from reporting if information was obtained in circumstances which were legally professionally privileged. *c.f.* the lack of any equivalent provision in draft regulation 15.

<sup>34</sup> at paras. 72 - 83 in particular.

<sup>35</sup> at para 76, citing *A M & S Europe Ltd v. Commission of The European Communities (Case 155/79)* [1983] QB 878, 949 at para. 18.

<sup>36</sup> at paras. 78 -79.

## Guidance incapable of curing the uncertainty

40. Draft regulation 41(2) provides:

*(2) In deciding whether a person has committed an offence under these Regulations, the court must consider whether he followed any relevant guidance which was at the time—*

*(a) issued by a supervisory authority or any other appropriate body;*

*(b) approved by the Treasury; and*

*(c) published in a manner approved by the Treasury as suitable in their opinion to bring the guidance to the attention of persons likely to be affected by it.*

41. It is therefore critical to determine whether, assuming such guidance is capable of curing the uncertainty identified above, it may properly form the basis of criminal liability. As noted above, the principle that criminal law must meet the requirements of reasonable certainty is “deeply embedded” in English law<sup>37</sup>. It is part of the overarching constitutional principle of the rule of law that:

“ ‘ Englishmen are ruled by the law, and by the law alone’, wrote Dicey. ‘A man may with us be punished for breach of law, but he can be punished for nothing else’. ... that there must be no crime or punishment except in accordance with fixed, predetermined law – this has been regarded by most thinkers as a self-evident principle of justice ever since the French Revolution. the citizen must be able to ascertain beforehand how he stands with regard to the criminal law; otherwise to punish him for breach of that law is purposeless cruelty.”<sup>38</sup>

42. As noted in the analysis above, however, predictability does not absolutely preclude judicial or external guidance in order to clarify the offence. For example, the fact that legal advice is necessary to elucidate the precise scope of the offence does not necessarily mean that legal certainty in Article 7 is not met: *Cantoni v. France* (RJD 1996 -V 1614); *Sunday Times v. UK* (*op cit.*) at para. 49. Moreover, external guidance has, on occasion, been sufficient to rescue apparent uncertainty in the ambit of a criminal offence. In *Ainsworth v. UK* (Application No 35095/97, 22 Oct 1998), for example, the Commission held that detailed military standing orders, which clearly prohibited consumption of alcohol by

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<sup>37</sup> See De Smith, Woolf and Jowell, *Judicial Review of Administrative Action* at para. 13-026.

<sup>38</sup> Glanville Williams, *Criminal Law: The General Part* (2<sup>nd</sup> ed., 1961) at p575.

under-age recruits, rendered the overall offence of “conduct to the prejudice of good order and military discipline” under s.69 of the Army Act 1955 sufficiently foreseeable and unambiguous so as to comply with Article 7. However, when appropriate, the European Court of Human Rights has re-affirmed the fundamental principle that the legislation itself must set out with reasonable clarity what is required and cannot await the interpretation of it by the courts: e.g. *Huvig v. France* (1990) 12 EHRR 528, esp. at paras. 33-35. In the context of a French law on telephone tapping, the Court said:

“In short, French law, written and unwritten, does not indicate with reasonable clarity the scope and manner of exercise of the relevant discretion conferred on the public authorities. This was truer still at the material time [because there had not yet been some of the safeguards introduced by judicial interpretation], so that Mr and Mrs Huvig did not enjoy the minimum degree of protection to which citizens are entitled under the rule of law in a democratic society. ...”

43. In *Rimmington*, Lord Bingham noted that the Strasbourg case law allowed for the possibility that:

“the law may be clarified and adapted to new circumstances which can reasonably be brought under the original concept of the offence...[b]ut any development must be consistent with the essence of the offence and be reasonably foreseeable ..., and the criminal law must not be extensively construed to the detriment of an accused, for instance by analogy ...”<sup>39</sup>

44. This affords a degree of flexibility to the legislature in drafting laws that are capable of extending to a variety of situations and whose interpretation and application can be left to questions of practice: *Sunday Times v. UK* (*op cit.*) at para. 59. Whilst such “gradual clarification” may include, for example, judicial explanation of the precise mental elements of anti-money laundering offences (see recently, for example, *R v Saik* [2006] UKHL 18), in our view it cannot properly extend to the determination of the overall ambit of the offence itself. Indeed if the very essence of the offence itself is uncertain, there exists a real possibility that the judicial interpretation of it may not be clear and consistent and sufficiently foreseeable. In this context the Strasbourg Court has also considered cases where it is not the development of the common law but the interpretation of a statutory

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<sup>39</sup> at para. 35.

provision that is novel. In *Kyriakides v. Cyprus*<sup>40</sup> the Court held inadmissible an application based on the unprecedented interpretation given to a particular statutory provision by the Supreme Court of Cyprus. However, the decision left open the possibility that, if an appeal court reverses a previous construction of a statutory offence which had been handed down before the defendant did the act charged, the new ruling may be held to contravene Article 7 in its application to the defendant if it was not (with the assistance of legal advice) reasonably foreseeable.

45. Obviously it is necessarily difficult to give absolutely firm advice in advance of the publication of any professional or industry guidance. However, in our view, the ambiguity surrounding the core definition in the draft regulations is of such a degree that any guidance would effectively be defining the ambit of the associated criminal offences, rather than clarifying their precise scope or their operation in certain circumstances. Guidance cannot itself take the place of law, and cannot fix fundamental deficiencies in the law, nor can it amend or correct the law where the law clearly provides to the contrary. In short, whilst it is always a question of degree, guidance cannot – as is the case here – take the place of clear, workable legislation. At best, it can reduce a small margin of uncertainty to an acceptable level but it cannot determine the ambit of criminal offences in a wide variety of commonplace situations. The position is, we think, qualitatively different to the (very limited) circumstances in which Parliament may choose to legislate in a non-criminal sphere by a Code of Practice rather than by a statutory provision or instrument: c.f. *R (Munjaz) v. Ashworth Hospital Authority* [2006] 2 AC 148. Recently, in a criminal context, in *R (Stellato) v. Secretary of State for the Home Department* [2007] UKHL 5 at para. 4, Lord Hope thought it would be “a remarkable feature of the case” if the effect of the relevant sentencing provision had been “achieved by a method of legislating that exposed the measure to the minimum of Parliamentary scrutiny.” In our view, that is the case *a fortiori* here if guidance were to purport to define criminal offences. The normal principle now is that only the legislature, not even the courts, can create new criminal offences: *R v. Jones (Margaret)* [2007] 1 AC 136.

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<sup>40</sup> App. No. 53059/99 (11 Dec. 2001) [2002] EHRLR 527.

46. In this context, the principled approach adopted in other jurisdictions is particularly instructive. In *Grayned v. City of Rockford* 408 US 104 (1972), for example, the United States Supreme Court identified:

“a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined. Vagueness offends several important values ... A vague law impermissibly delegates basic policy matters to policemen, judges and juries for resolution on an *ad hoc* and subjective basis, with the attendant dangers of arbitrary and discriminatory application.”

Lord Phillips MR approved these *dicta* in *R (L and another) v. Secretary of State for the Home Department* [2003] 1 WLR 1230 at para. 25.

47. Furthermore, whilst Treasury-approved guidance may be a defence to certain anti-money laundering offences, it may not offer complete protection in all situations, nor can it be relied upon with certainty as prohibiting prosecution if later administrations or other prosecuting agencies decided that they disagreed with the guidance given by the Law Society.<sup>41</sup>

## Conclusions

48. Legal advisers specialising in trust law consider that there is real uncertainty in the operation of the core “beneficial owner” test contained in the draft regulations in a broad range of commonplace situations. In our view, the consequence is that the associated criminal offences contained in the draft regulations do not meet the Community law, common law and ECHR requirements of legal certainty and, accordingly, would be open to challenge. The ambiguity surrounding the core definition in the draft regulations is such that any guidance issued would effectively be defining the ambit of the associated criminal offences, rather than clarifying their precise scope or operation in certain circumstances. Such guidance would be taking the place of legislation and would accordingly be

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<sup>41</sup> c.f. e.g. a prosecution following police representations not to prosecute which were incapable of binding the CPS nevertheless amounted to an abuse of process: *R v. Croydon Justices ex p Dean* [1993] QB 769 at pp776-7.

constitutionally prohibited. Our view would be unaltered even if, for example, the guidance were drafted by the Law Society and approved by HM Treasury.<sup>42</sup>

49. The only safe course to avoid legal challenge is for HM Treasury to re-draft the draft regulations so as to include a more detailed definition of “beneficial owner” than is contained in the Third Money Laundering Directive in order to provide sufficient clarity and precision as regards its interaction with English trust law. So far as we are aware, no-one has suggested that such a definition is *impossible* or even difficult to formulate – HM Treasury merely considers that it would be “unhelpful” to do so. Presumably HM Treasury consider that a definition *could* be provided in the form of guidance – if that is so, it could be set out in the regulations themselves.

50. The United Kingdom cannot abrogate its legal responsibility only to create sufficiently clear and precise criminal offences, merely because the Directive it seeks to implement is itself (on its face) uncertain. Legal certainty as regards criminal offences is an obligation at the national level, not least under the Human Rights Act. Obviously, the consequences for a regulated legal professional who was convicted of an uncertain criminal offence of failing to comply with anti-money laundering obligations are serious. The wider ramifications for the rule of law and the unfettered ability of citizens to obtain confidential legal advice<sup>43</sup> are also considerable.

51. For the avoidance of doubt, we stress that it is difficult to conceive of circumstances in which the legal certainty of the draft regulations could be challenged in the courts except at a criminal trial (or any subsequent appeal) for an offence under the regulations as enacted. The courts would not be sympathetic to an “academic challenge” or test litigation based on hypothetical facts: c.f. *R (Rusbridger and another) v. Attorney General*<sup>44</sup> and *R (Burke) v General Medical Council*<sup>45</sup>. This is another reason why it is highly unsatisfactory to proceed to

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<sup>42</sup> See draft regulation 41(2). c.f. s.330(8) of the Proceeds of Crime Act 2002 Act and regulation 3(3) of the Money Laundering Regulations 2003 which provide that it is mandatory to take such approved guidance into account.

<sup>43</sup> Having regard to the 20<sup>th</sup> recital in the preamble to 3MLD.

<sup>44</sup> [2004] 1 AC 357.

<sup>45</sup> [2005] 3 WLR 1132.

legislate in the way proposed by HM Treasury: a shadow will remain over the legislation unless and until individuals are prosecuted, with the attendant risks which will be borne by those individuals.

**RABINDER SINGH QC**

**ALEX BAILIN**

**Matrix**

**26 March 2007**