ThoughtLeaders4 FIRE • JULY 2021

FIRE MAGAZINE

Fraud • Insolvency • Recovery • Enforcement

ISSUE 5

FIRE Future Of Fraud

THE GLOBAL ASSET RECOVERY COMMUNITY

INTRODUCTION

"My interest is in the future because I am going to spend the rest of my life there."

- Charles Kettering

To misquote the lyrics of the great Mungo Jerry – "In the summertime, when the weather is hot, You can stretch right up and touch the sky, When the weather's right, You got THE FUTURE, You got THE FUTURE on your mind".

Now that school is out for summer the minds of our contributing authors turn to the future and what this means for the Fraud and Asset Recovery Community.

Looking beyond the summer, September hots up with a full Autumn/Winter programme of in person FIRE events. Join us at…

FIRE UK Welcome Back – 23rd & 24th Sept 2021
FIRE Starters in London – 20th Oct 2021
QC Surgery: Fraud - 2nd Nov 2021

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"FUTURE OF FRAUD"

Authored by: Steve Holt – Grant Thornton

ESG reporting manipulation

The manipulation of financial statements – whether it be in the pursuit of personal reward, to meet market expectations that are out of reach or to paint a misleading picture of financial health – has long been a tool of choice for fraudsters seeking to meet illicit objectives.

While this will undoubtedly continue, particularly in choppy economic waters, a new set of measures that are rife for abuse are soon to come front and centre of mind for most businesses – those relating to Environmental Social and Governance (ESG) disclosures.

What is ESG and why is it important?

There is currently no widely accepted definition of what ESG encompasses. At its broadest, it covers every aspect of a business and its operations – from how it treats its employees to the furthest flung parts of its supply chain and is under constant scrutiny from a range of interested parties.

It is no longer enough to simply operate a business in an ethical manner, one now needs to operate in a demonstrably ethical manner or face the wrath of the market – for instance, following a series of allegations in connection with the operation of elements of its UK-based supply chain during the onset of the Covid-19 pandemic, listed online retailer Boohoo launched an independent review of its actions in order to assuage concerns of investors which led to a dramatic decline in share price.

A company's ESG stance affects its access to capital markets (and the attitude of participants in capital markets towards the business), influences the nature and cost of lending and impacts employee, consumer and counterparty behaviour more than ever before.

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The near future also brings with it regulatory hurdles connected with ESG disclosure. The United States Securities and Exchange Commission (SEC) has already started to emphasise a focus on ESG reporting, and the Bank of England is performing a stress test on the UK financial system's exposure to climate-related risks. Anticipate seeing much more stringent review and assessment of ESG-related disclosure from a regulatory standpoint in the coming months and years.

Why will this lead to fraud?

The current environment provides all three elements of the oft-touted "fraud triangle" – pressure, opportunity and rationale.

Pressure

Companies are under increasing pressure to meet ESG expectations from both internal and external perspectives. Many are playing catch up with grand statements made by executives (such as those relating to becoming "net zero" – seeking to reduce or offset emissions generated via operations with efforts to remove emissions to have a "net zero" emissions impact) and are seeking to back-fill capability to understand exactly how they do this while continuing a focus on operating profitably in a complex economic environment.

Others simply have operating models that are incredibly difficult to convert to be considered "ESG-friendly" but are still facing calls from key stakeholders to maintain profitability while making strides towards a more palatable ESG footprint.

Opportunity

In tandem with pressure comes opportunity. ESG-related disclosure is in its infancy and there are many avenues through which companies can give the impression of reaching set targets.

The most direct and commonly known method, known as greenwashing (and in some corners, bluewashing), essentially utilises marketing and public relations efforts (such as advertisements, marketing campaigns, subscriptions to trade bodies, public statements regarding "positive" ESG activity that do not stand up to detailed scrutiny, etc) to give the deceptive impression of a company's "true" performance against loosely-defined ESG metrics.

However, most ESG metric reporting should be based on data collected by an organisation from several different sources, including from all elements of its supply chain. Many businesses are not currently set up to obtain or provide meaningful data on ESG factors, and many counterparty relationships were incepted before a time ESG-related reporting was envisaged – meaning that there is often limited scope to utilise contractual mechanisms to inspect a counterparty's adherence to ESG requirements.

As a result reporting on ESG-related performance is ripe for manipulation and can directly impact a series of stakeholder decisions relating to interaction with a company.

Rationale

Rationale is often the most personal aspect of the fraud triangle and varies upon the fraudster's situation, and this is no different in the case of ESG reporting. However, given the relative lack of knowledge and perceived complexity of ESG reporting, there is a large cohort of those charged with this task that can be described as ignorant to manipulation and forthright in their belief that they are doing the right thing.

There is increasing evidence showing employee commitment to companies with a strong sense of ethical purpose. This commitment, while commendable, can encourage a blindness to fraud-related issues where challenging the issue could be considered to conflict with the sense of purpose.

Warning signs of fraud

There are several warning signs of ESG-related fraud, many of which are familiar to those involved in the investigation of financial statement fraud:

- Overperformance against expectations, or in the face of strong headwinds – those businesses that seemingly consistently outperform expectations against ESG metrics, particularly in times of challenge (such as the closure of emission-effective supply routes)
- Indications of a historical vocal market participant suddenly going quiet in the face of challenge – it is much easier to "talk the talk" than to "walk the walk"
- Over-reliance on third party credentials to support an ESG posture – with some notable exceptions, credentials are currently typically straightforward to obtain with several widely-recognised credentials being "awarded" via payment of a fee and without detailed verification of statements made by the company in support of declarations made
- Adoption of a different method of measuring the same things – like changes in accounting policy (an oft utilised tool in the manipulation of financial statements), changes in measurement approach for ESG metrics can lead to a sudden improvement in performance or paper over the cracks of a failing ESG approach.

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ALL FAIR IN LOVE AND LIQUIDATION?

Authored by: Alexander Heylin and Annie Townley – No.5 Barristers Chambers

The authors of this article recently appeared in a 10 day High Court trial in front of Mr. Justice Meade in Biscoe and Baxter as Joint Liquidators of Equitable Law Capital Limited v Milner [2021] EWHC 763 (Ch). The authors represented the 6th and 7th Respondents against whom all claims were dismissed.

This article concentrates on only one of the key areas of the judgment namely the collection of evidence by a Liquidator (or other office holder) and the Liquidator's duty to be fair and impartial.

Background

Equitable Law Capital ('ELC') set up a scheme in 2014 seeking investment for claims against banks for mis-sold investment bonds to be pursued by a claims management company ('CMC'). The loans made by ELC to the CMC for this purpose were covered by an insurance policy in the name of ELC. The Scheme was marketed to potential investors through a marketing brochure.

The FCA investigated ELC from 2015 onwards for potential breaches of FSMA and ELC stopped receiving investments after March 2016. ELC entered into voluntary liquidation in October 2016 and liquidators were appointed. During investigations it became clear that the brochures contained false information, the CMC was pursuing PPI claims rather than bond mis-selling claims and of the £3.3 million ELC received, the parties involved with the scheme received just under £2.2million either personally or into connected companies, compared to only £230,000 received by the investors.

In January 2019, the Liquidators brought an application against 9 respondents including the sole de jure director, individuals involved in setting up the scheme, the marketing agent and the insurance broker. The Application contained allegations of breach of directors duties and fiduciary duties, conspiracy, fraudulent and wrongful trading, dishonest assistance and transactions at an undervalue.

"A liquidator conducting an investigation into a contentious issue arising in a company's affairs should strive to gather and review all readily available evidence on that issue on an impartial basis. He should be alive to the possibility of conjecture and unsubstantiated opinion. He should re-evaluate evidence as the investigation progresses" - Re Guardian Care Homes (West) Ltd (In Liquidation) [2018] EWHC 2664 at [116].

Liquidators duty of impartiality

It was essentially uncontested that the Liquidator had a duty to approach the investigation in a fair and impartial way. The comment from ICC Judge Barber that started this article was an agreed point of law [59].

In post-trial submissions the Authors also relied on the Judge's comments in Re Keeping Kids Company [2021] EWHC 175 (Ch) at [899]-[902], in which the Official Receiver had received criticism about not keeping an open mind in respect of the case against the Respondents.

Findings of failings in respect of investigation and impartiality

The Judge identified at [63] his major concern –

"the one that troubles me the most is iii) – the way that documents were provided. It is the one that has the most direct impact on my ability to make full, accurate and informed findings of fact."

In particular -

a) Failure to seize key documents from ELC and unequal treatment of the Respondents which created difficulties for all sides in identifying when certain decisions were made and by whom and highlighted a key and unjustified gap in the Liquidator's investigation.

"Further, questions 41 to 43 of the Questionnaire identified that ELC had kept accounting records and that statutory records and a minute book had been kept. These should surely have been the first port of call, but Mr Biscoe did not secure them."[67]

"The Liquidators used more care and energy over getting in the documents of the other Respondents than they did of the Milners. They did not obtain Lillie Milner's computers or telephones or the documents identified in Graham Milner's Questionnaire and they did not use their compulsory powers under s. 236 IA86 (which they did with David Clarkson). The explanation was offered that that was because it would not have been possible to go behind a witness statement from the Milners that they had provided everything, but I do not accept that because at the very least the documents identified in the Questionnaire had plainly not been provided." [68]

b) The manner in which the documents from the Milners, who had settled pre-trial, had been provided as forwarded hard copies of emails and screenshots of texts rather than original electronic copies. The Judge said at [71] and [72] -

"Both of these raised the possibility that Lillie Milner could give over materials that were selective, or redacted, or tampered with. I have already said that I think she had the potential positive motivation to try to cast the blame elsewhere. No adequate justification for this approach was given."

c) There were also criticisms of other parties whose disclosure was deemed to be incomplete without any reason. In considering the documentary evidence, the court categorised it according to its source [81-82]

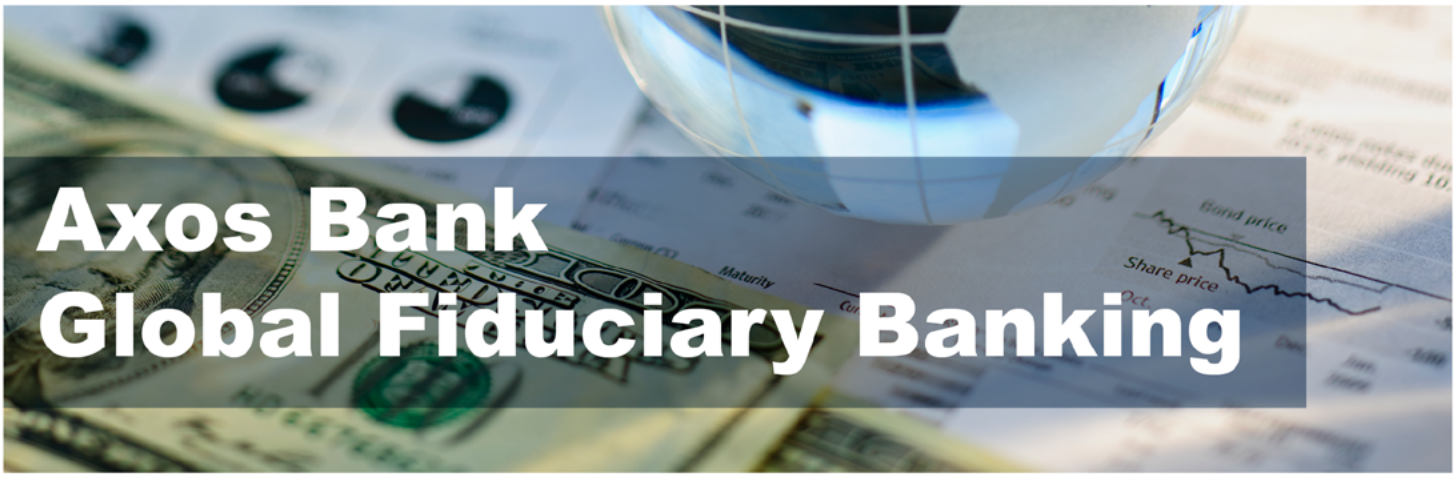
Impact of these findings on findings of fact

The Judge highlighted some of the problems that the inadequate investigation had in relation to him making findings and the impact that had on the Applicant's case at [79] – [83], which required the Judge to consider the variation in quality of evidence when comparing oral testimonies against the documentary evidence, particularly where there were clear gaps in the evidence or where documents had plainly been tampered with.

Takeaways from this case for Liquidators and Respondents

It is no exaggeration to say that the most fundamental reason that the above findings were disastrous on the Liquidator's claims against the 5th, 6th and 7th Respondents is that the lack of basic documents and the severe issues over provenance of documents that were produced severely undermined the case being presented by the Applicants. The issues

The case is a powerful reminder to Liquidators that they are not like a normal Claimant; they have a duty to remain impartial and must be meticulous in their collection of the evidence and objective in their analysis of the evidence as the case progresses. A dogmatic to culpability and a less than thorough and balanced investigation is likely to cause severe problems at trial.



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Marchand Boyd has focused his decades-long Fiduciary Banking career on fostering consultative, client-centric partnerships. Exercising deep-rooted industry knowledge, Marchand formulates market and engagement-specific deposit management solutions, empowering his clients with the specialty banking accommodations they need to successfully administer their fiduciary responsibilities. For more information, visit www.axosbank.com/gfb.

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OUT OF WALLET BUT FROM WHOSE POCKET?

HOW CRYPTOCURRENCIES CAN BE TRACED

Authored by: Helena Bowyer, Ezra Cohen and Ryan Rubin - Ankura

Cryptocurrency was designed to bring about more financial autonomy, offering individuals, wherever they may be in the world, access to a store of value and a monetary network independent of state control. This concept has underpinned the exponential growth cryptocurrencies have experienced, with as many as 100,000 investors holding more than USD 1 million in Bitcoin by February 2021. As with any asset class, however, this impressive growth has inevitably opened up an opportunity for fraud and corruption, leaving some investors significantly "out of wallet". As these trends continue to grow, so does the need for crypto tracing services either as part of a wider asset tracing exercise into a debtor or in helping to unpick a complex web of transactions and locate misappropriated cryptocurrency. Whilst this can seem a challenging prospect, tracing cryptocurrency transactions is in many ways more feasible than other forms of asset tracing, provided one is equipped with the necessary expertise. The recent success of the US Department of Justice in recovering USD 2.3 million worth of misappropriated Bitcoins following the Colonial Pipeline ransomware attack was only the latest demonstration of how this can be done.

If public cryptocurrencies such as Bitcoin and Ethereum often create greater opportunities for asset tracing than traditional fiat currencies, the principal reason for this stems from their building blocks. One of the most salient features of cryptocurrencies is the use of blockchain technology and a digital ledger where all transactions are recorded and visible for all crypto traders. Each and every trade is recorded here with both the seller's and buyer's pseudonym appearing on the ledger. Whilst the owners of these pseudonyms can be vague, in some cases they can provide investigative clues which aid the identification of the individual behind the cryptocurrency address or wallet. If an investigator is able to positively identify an owner, they may be richly rewarded; the interconnected nature of the ledger means that a single confirmed data point can ultimately lead to the unravelling of a network of individuals and assets.

A technique deployed by fraudsters in recent times has been the layering of multiple transactions through crypto currency exchanges and coin-mixing, a service which allows users to mix their cryptocurrencies in a single pool and obfuscate its origins. However, the advancement of crypto-tracing abilities has meant that even these complicated and confusing techniques can be unravelled when transactions produced through the coin mixer hit a known exchange and can be traced.

A technique deployed by fraudsters in recent times has been the layering of multiple transactions through crypto currency exchanges and coin-mixing, a service which allows users to mix their cryptocurrencies in a single pool and obfuscate its origins. However, the advancement of crypto-tracing abilities has meant that even these complicated and confusing techniques can be unravelled when transactions produced through the coin mixer hit a known exchange and can be traced.

While these techniques will often form the basis to an investigation, crypto tracing will typically also require the collaborative work of cyber and digital forensics teams as well as cryptocurrency exchanges. These groups have the tools and resources to gather crucial clues for tracking and tracing crypto assets. Whilst there may be anonymity behind the ownership of crypto assets, digital footprints get left behind which can be used to piece together associations between individuals and anonymous activities. Examples include internet browsers, password managers, exchange accounts, cryptographic keys and wallets stored on hard drives or even casual conversations in chat messages and social media on mobile phones.

Investigating cryptocurrency assets in this manner requires technical expertise of a kind that is now utilised as standard in such cases. A thorough asset tracing investigation will be similarly lacking, though, if these technical skills are not deployed in tandem with many of the more traditional asset tracing tactics.

At the outset, for example, open-source investigation tools can be used to build a profile of the subject and inform an assessment of whether they are likely to hold any cryptocurrency assets in the first place. Our experience suggests that individuals with significant sums in cryptocurrency are usually not shy about showing their enthusiasm for the asset class - or even particular cryptocurrencies and exchanges - on social media accounts and in other public forums.

Those investors in the sector who are more discreet might still find themselves undone by another constant of corporate intelligence: leaks. The rising popularity of cryptocurrency has been closely followed by the growing frequency of prominent industry leaks, from Bitmex in 2019 to BTC Markets in 2020. In both of those instances, tens of thousands of users at each exchange found their email addresses published online. With the right resources, these email addresses will almost invariably lead to the owner's underlying identity. Whether from human error or hackers' efforts, the emergence of these databases will unquestionably prove an increasingly important resource for any asset trace with a cryptocurrency angle.

Finally, it is a truism of asset tracing that the right legal tools can be crucial to an investigation, and this is no less true in the case of cryptocurrency assets. Depending on the jurisdiction in question, mechanisms like subpoenas and court orders can be vital tools to locate assets and pierce the cryptocurrency veil. One crucial caveat here is that the results obtained from these means can vary wildly. While exchanges registered in highly regulated jurisdictions such as the US and UK generally prove more co-operative following subpoena requests, access to transactions and account history in less regulated countries can be challenging. The information provided can also vary in the extreme depending on the meticulousness of the KYC tools implemented by each exchange, with certain exchanges providing details down to transaction dates while others restrict their output to only the most high-level information.

Despite, or perhaps even due to the novelty of cryptocurrencies, they are steadfast becoming a well-established investment opportunity for the wealthy alongside more traditional assets such as properties and luxury vehicles. Equally, cryptocurrencies have provided a new medium through which fraudsters can operate. This dichotomy means that the work of crypto tracers is ever evolving in conjunction with legal, cyber and IT forensics specialists to hunt down even the most obscured of transactions as cryptocurrency and related fraud become more evermore mainstream.

DIRECTORS DUTIES

THE PRIVY COUNCIL OVERTURNS CONCURRENT FINDINGS OF FACT OF ITS LOWER COURTS

Authored by: Rick Brown and Joshua Prest - HFW & Scott Cruickshank and Jonathan Child – Lennox Paton

The Privy Council has recently handed down its decision in the case of Byers v Chen Ningning [2021] UKPC 4. The decision provides an example of the rare occasions in which the Privy Council will overturn findings of fact from the lower courts and provides important guidance and findings of breach of fiduciary duty of a director in a BVI registered company.

The liquidators' legal team was comprised of Stephen Smith QC and Ben Griffiths of Erskine Chambers, together with HFW (as Privy Council agents) and Lennox Paton.

This decision is of significance to commercial practice in the BVI and provides welcome guidance to directors of BVI companies as well as to appointed insolvency practitioners who might be faced with bringing proceedings for and on behalf of a company against former directors for breach of their duties whilst in office. This judgment also provides further commentary and assistance on when it will be appropriate for an appellate court to intrude upon and reassess findings of facts by lower courts. In this case the Privy Council overturned decisions of both the BVI High Court and the Eastern Caribbean Court of Appeal.

The facts of this case relate to a BVI company called Pioneer Freight Futures ("PFF") which was incorporated and established for the purpose of trading forward freight agreements. The futures contracts that PFF entered into related to rates for the shipment of freight, which allow shipowners and traders to manage their future exposure to the volatility of freight rates and costs.

In October 2009, and as a result of litigation that had taken place in London, PFF acknowledged that it was commercially insolvent. Shortly thereafter, in November 2009, PFF repaid a loan of US$13 million in three tranches to a company called Zenato Investments Limited ("Zenato"), which had been entered into in May 2009. A matter of weeks after the loan was repaid, in December 2009, PFF was caused to enter into liquidation at the hands of its sole director ("Miss Chen").

In 2014, after carrying out their investigations, the liquidators from Grant Thornton were in a position to make a proposed interim dividend to PFF's creditors of 6%. Pursuant to that dividend, Miss Chen would have been due a personal payment of US$5.4 million as a result of an assignment which had placed the debts of PFF to its parent company. The liquidators withheld the payment of this dividend to Miss Chen on the basis that they contested that Miss Chen had wrongfully caused for the repayment of the US$13 million loan to Zenato.

4 Miss Chen made an application to the BVI High Court for the payment of the interim dividend which had been withheld by the liquidators. Shortly thereafter, the liquidators also issued proceedings in the BVI High Court against Miss Chen for the sum of US$13 million together with interest. The liquidators' claim was based on Miss Chen's: (i) alleged breach of fiduciary duty as a de jure, de facto or shadow director of PFF, or someone whose role in the affairs of PFF justified the imposition of fiduciary duties, and (ii) for the restoration of an unfair preference (as a voidable transaction within the meaning of, respectively, sections 245 and 244 of the Insolvency Act 2003).

5 It was common ground between the parties that Miss Chen had been PFF's sole director until the end of May 2009. However, there was a dispute as to when Miss Chen had resigned her directorship and the extent of her involvement in effecting the repayment of the loan to Zenato (this was despite the fact that Miss Chen had been the sole signatory for the bank accounts of PFF at the time when the relevant transfers were ordered/made).

6 A 4 day trial at first instance took place before Bannister J in March 2015 and a short judgment was handed down less than 2 weeks after that trial concluded. Bannister J dismissed the liquidators' claims and expressed himself in "forthright and robust" terms (as described by the Privy Council) when considering and addressing the claims brought by the liquidators.

7 The liquidators appealed this decision, and the subsequent appeal was heard over a period of 2 days in January 2016. Judgment for the appeal was not handed down by the Eastern Caribbean Court of Appeal until June 2018 (being 2 ½ years later), upholding the first instance decision.

8 The appeal before the Privy Council was heard in June 2020 before a board comprised of Lord Kerr, Lord Briggs, Lady Arden, Lord Kitchin and Lord Leggatt. Judgment was given on 22 February 2021. In its judgment the Privy Council found that:

– The BVI Commercial Court and Eastern Caribbean Court of Appeal had been wrong to accept that Miss Chen had resigned her sole directorship in May 2009 (or at all). The Privy Council found that Bannister J's findings of fact on this issue were not supported by any evidence, and as such, that the Judge had made an error of law. The Eastern Caribbean Court of Appeal had also failed to intervene and had therefore promulgated that error.

– Having found that Miss Chen had not resigned from her directorship of PFF, and that by implication she had continued to owe fiduciary duties to PFF, the Privy Council then went on to assess whether the duties owed by Miss Chen to PFF had been breached. The Board was definitive on that question and found that Miss Chen had breached her fiduciary duties in allowing the repayment of the Zenato loan. Miss Chen, as the person who was the sole signatory of the company's trading account, had a fiduciary duty to PFF to take all reasonable steps to prevent a payment being made from that account for an improper purpose. The Board re-stated well-worn principles in this respect and commented that:

" [Miss Chen] could not evade [her fiduciary duties] to PFF and, through PFF, to its creditors, simply by delegating to an employee or a de facto director her authority to make payments from PFF's account." "It has been held in a number of cases, correctly, in the Board's opinion, that a director may not knowingly stand by idly and allow a company's assets to be depleted improperly: see, for example, Walker v Stones [2001] QB 902, at 921D-E per Sir Christopher Slade; Neville v Krikorian [2006] EWCA Civ 943; [2007] 1 BCLC 1, paras 49-51 per Chadwick LJ; Lexi Holdings v Luqman [2007] EWHC 2652 (Ch), paras 201-205 per Briggs J (as he then was). To the contrary, a director who knows that a fellow director is acting in breach of duty or that an employee is misapplying the assets of the company must take reasonable steps to prevent those activities from occurring."

– With respect to the delay in the Court of Appeal delivering its judgment, the Board accepted that the delay had been excessive and that this therefore justified the careful consideration of the merits of the appeal by the Privy Council.

Conclusion

Byers v Chen Ningning is a timely reminder of the duties which BVI directors owe to the companies to which they are appointed and the need for directors to take reasonable steps to prevent any breach of duty or misapplication of the assets of the company concerned. The decision also offers further additional judicial guidance and commentary as to when an aggrieved party can ask an appellate court to intervene in substance due to excessive delays in the usual processes of the court and the administration of justice.

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FROZEN IN TIME:

DO LIMITATION PERIODS APPLY TO CLAIMS AGAINST CAYMAN COMPANIES IN LIQUIDATION?

Authored by: Jennifer Fox and Victoria King – Ogier

Legal claims can only be brought within the applicable limitation period prescribed by the Limitation Act (1996 Revision). A defendant to any claim that is time-barred has a complete defence. Prior to the recent decision of Ritchie Capital Management LLC et al (Ritchie) v Lancelot Investors Fund Ltd (Lancelot) and General Electric Company (GE), it had been generally understood that the Cayman approach to claims against companies in liquidation would follow the English position on the issue of limitation. That is, the limitation period will cease to run once the company goes into liquidation, with some exceptions.

The Cayman Grand Court, however, in the unreported case of Ritchie, has challenged this assumption and reinterpreted the principles from the English authorities on this important point.

Lancelot is a Cayman Islands entity which was placed into official liquidation in the Cayman Islands on 10 December 2008. It was one of three related funds; the other two were incorporated in Delaware and also filed for bankruptcy in 2008. Ritchie brought proceedings in Cayman against both Lancelot and GE for deceit and unlawful means conspiracy. Ritchie claimed to have lost sums in excess of US$200 million as a result of investing in funds such as Lancelot, which was a feeder fund for investment into the Petters Group Ponzi scheme. Ritchie served proceedings on Lancelot on 21 May 2019. Ritchie obtained leave on an ex parte application to serve the proceedings on GE out of the jurisdiction by establishing, inter alia, that the claims against the Cayman "anchor" Lancelot raised a real issue to be tried. GE applied to set aside this order on several grounds, including that the claims against Lancelot were time-barred given the expiration of the applicable limitation period.

Ritchie relied on the English authority of General Rolling Stock and subsequent supporting English authorities to argue that as a result of the winding up of Lancelot on 10 December 2008, time ceased to run on any applicable limitation periods from the date the petition was presented, meaning that Ritchie's claims against Lancelot were not time barred. This, Ritchie argued, was the case regardless of whether those claims arose out of legal causes of action in tort, or in contract, or were disputed, or not.

Parker J rejected this argument for several reasons[1].

First, he considered that neither the Limitation Law[2] nor the Companies Law (2020 Revision or any prior enactment) or any other Cayman statute provides for the suspension of the running of time for such actions upon the commencement of a Cayman company's official liquidation.

Second, the Court rejected the argument that the English authority of General Rolling Stock[3] and subsequent authorities supported the proposition that the provisions of the Limitation Act should be disregarded. In General Rolling Stock, the Statute of Limitations was suspended as long as the debt was not statute barred as at the date the insolvency proceedings commenced. In other words, for as long as the assets had not been liquidated and distributed to creditors, creditors were at liberty

1 [51], Ritchie

2 We note that the legislation are now referred to as "Acts", not "Laws", pursuant to the Citation of Acts of Parliament Act 2020

3 (1872) LR 7 Ch App 646,Taffs Well [1992] Ch 179 at p 191

to prove their claim in the liquidation (via the proof of debt procedure). Crucially, the Court held that General Rolling Stock was not authority for the proposition that the effect of the commencement of Lancelot's liquidation stopped the clock running on any applicable limitation period relevant to available legal claims. Rather, General Rolling Stock was a case, properly understood, about the liquidation process and the impact this has on the ability of creditors to pursue claims[4].

Parker J held that Financial Services Compensation Scheme Ltd v Larnell (Insurances) Ltd (In Liquidation) [2005] EWCA Civ 1408 confirmed that the proposition to be derived from General Rolling Stock is that the right to enforce a claim against the assets of a company in liquidation is to be ascertained as at the date of commencement of the liquidation. The right to prove in the liquidation is not lost by reason of any applicable limitation periods (ie the operation of the Limitation Act) as long as the claim is not time-barred as at the date of the commencement of the liquidation[5].

In doing so, Parker J rejected the English Court's approach in Larnell that either a claim can or cannot be brought irrespective of the method of bringing that claim (ie either via legal proceedings or via the proof of debt process in a liquidation). In Larnell, Moore-Bick LJ found it impossible to accept that the same claim can be time-barred for one purpose but not for another. Parker J disagreed with this view. He considered that the mechanism of pursuing a claim did impact on the applicable limitation period; thus there should be a difference in approach to limitation dependent on whether a creditor is bringing an action by way of court proceedings or establishing its right to prove in the liquidation[6].

As such, since Lancelot was pursuing its claim in court proceedings, its winding up did not suspend the limitation period relating to these claims, regardless of whether they were commenced before, during or after the winding up procedure.

Third, the Court held that it would be contrary to the policy behind the Limitation Act for it not to apply to actions brought by way of court proceedings simply because a defendant company has been wound up[7]. The Limitation Act promotes commencement of actions within a reasonable time period and provides certainty and finality as to the opportunity to bring claims. Parker J also commented that to follow the approach in Larnell, effectively stopping the clock on both types of claims, would lead to the "strange result" that the winding up procedure changes the characteristics of the creditor's rights and the nature of the debts which can be enforced by way of court proceedings. This seems to go against Lloyd J's comments in Larnell that it is wrong to describe the effect of the commencement of a liquidation process as converting the nature of creditors' rights; it is only the way in which those rights may be given effect to that is affected on commencement of the winding up.

The Cayman Court therefore held that the primary limitation period for the claims made in the proceedings issued by Ritchie in Cayman on 21 May 2019 had already expired five years previously in 2014, and they were time-barred.

The approach in Ritchie may be summarised as: (i) limitation periods continue to run with respect to legal claims pursued against companies in liquidation by way of court proceedings but (ii) limitation periods are suspended on the date the insolvency process commences with respect to liabilities sought to be proved in the liquidation process via a proof of debt[8]. However, it is important to note that the Ritchie decision is being appealed and therefore Parker J may not have the last word on this issue. Nevertheless, if the decision is upheld it may well have a significant impact in limiting time-barred claims to a resolution within the proof of debt process if it is followed by other Judges of the Grand Court.

4 [58], Ritchie

5 [56]-[65], Ritchie

6 [64] Larnell

7 [69]-[70] Ritchie

8 [65], Ritchie

FRAUD AND RECESSIONS ARE NATURAL BEDFELLOWS

Authored by: Tim Symes and Alex Jay - Stewarts

The increase in fraud following the 2007-8 financial crisis was sharp and sustained. KPMG's 'Fraud Barometer' – the longest-running fraud report of its kind in the UK – showed that fraud cases in 2008, 2009, and 2010 increased year-on-year both by value and volume.

In the most famous cases of the 20th century, fraud has either precipitated insolvency or generated fraud because of it. Take Lehman Brothers, where securities were removed from balance sheets to give a materially misleading picture of the firm's finances shortly before its collapse. Also, Stanford International Bank, a Ponzi scheme that unravelled after the 2007-8 financial crisis hit as investors rushed to redeem their deposits. Stanford's fraud then went into overdrive by fabricating stories to hide the underlying fraud.

Wirecard provides a more recent example of fraud on a grand scale. It was discovered that billions of euros believed to be held by a third-party trustee Singapore bank didn't actually exist. Wirecard entered formal insolvency in Germany in June last year, owing some €3.5bn to creditors.

The Carillion and Patisserie Valerie insolvencies provide two home-grown examples of at best aggressive accounting and at worst possible fraud. These cases raise serious concerns about the adequacy of the UK's current audit function and process.

The UK government plans to tighten up the UK's audit function. Under proposed new rules, directors are to become individually responsible for the accuracy of accounts. There will also be a new regulator created, the Audit, Reporting and Governance Authority, which will be given teeth to investigate and sanction auditors. Crucially, it will compel auditors to actively look for fraud and abuse when carrying out their audit.

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Then we come to Coronavirus: not only a natural disaster but an economic one too. Two of a fraudster's favourite situations in one.

Natural disasters are another situation to which fraudsters are attracted, enabling them to exploit relief monies and abuse rebuilding grants. This occurred during the Indian Ocean tsunami relief effort with both Save the Children and Oxfam falling victim.

The UK foot and mouth outbreak was another opportunity for fraud, according to reports. Some farmers were accused of deliberately infecting their animals to take advantage of the government's generous compensation scheme, which made a sick animal worth more than a healthy one.

Then we come to Coronavirus: not only a natural disaster but an economic one too. Two of a fraudster's favourite situations in one.

At the moment, Covid-19 is a medical emergency. However, when the vaccination roll-out has concluded and the last loan drawn, furlough payment made and creditor enforcement restriction lifted, it will become an economic one.

The chancellor has said the furlough scheme will end in its present form in June this year. It will be replaced with reducing support until the end of September, with employers shouldering the difference.

Apart from the recession experienced in the first half of last year (when the economy shrank by over 20% as against the first quarter), the full extent of the impact of Covid-19 is barely visible. Indeed, if you didn't know there was a pandemic, a glance at the UK's January 2021 corporate insolvency figures – 50% down on the same time last year – would have you believe the country's economy is doing rather well. It isn't.

This post-protection environment will, therefore, see a spike in insolvencies, not only as a correction to pre-pandemic levels but due to the effects of three lockdowns. With it will come poor ethical behaviour, fraud and other abuses.

We will see wrongful and fraudulent trading and attempts to avoid onerous obligations by setting up new companies and transferring the business across to them free of debts. Assets will be magicked away in an attempt to put them out of bounds of creditors once they come knocking.

Often these behaviours only get uncovered by a liquidator or administrator officeholder once the company goes into formal insolvency. Officeholders have unique, extensive and unparalleled investigatory and recovery powers robustly upheld by the courts. This can make the tactical use of a formal insolvency process to uncover wrongdoing and recover assets a rational step for stakeholders defrauded or otherwise deprived of their money.

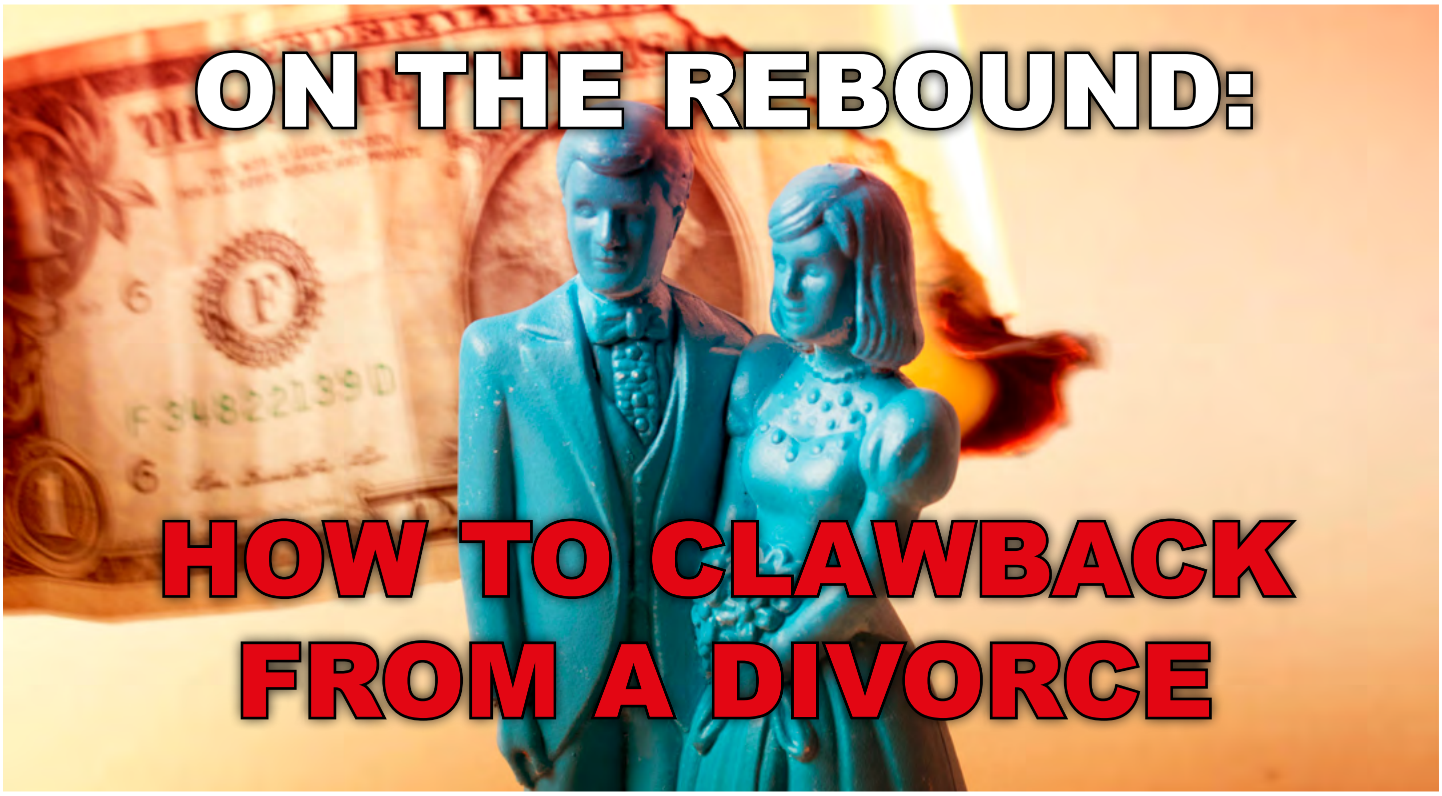
Whereas a potential claimant who suspects fraud must rely on the counterparty to voluntarily deliver up documents pre-action or be compelled to do so by a court application, a liquidator's requests for information must be complied with according to statute. A failure to cooperate can lead to the court ordering anyone it thinks can give relevant information on the company to come before it and be examined under oath. If they decide not to turn up for no good reason, they can face a contempt of court prosecution and a spell at Her Majesty's pleasure.

Add to these extraordinary powers the wide categories of information and documents the liquidator can legitimately require, which is basically anything relating to the company. In effect, liquidators have an unparalleled pre-litigation evidence-gathering advantage simply not available in a standard commercial litigation setting.

Fortunately, the officeholder is not hamstrung by funding issues when asserting these powers or issuing later proceedings. If they were, their principal function of collecting in and realising assets would be hopelessly thwarted.

There are many funding options available to an officeholder via a combination of conditional or contingency fee arrangements and third-party funding. At the same time, the officeholder can de-risk the claim with an adverse costs insurance policy.

Overall, we can expect insolvency to feature in several ways over the coming years. As companies restructure or fail, the darker side of ethical behaviour (in other words, fraud) will be uncovered. This will have a long tail that could well outlive the Covid-19 crisis by some margin.



ON THE REBOUND: HOW TO CLAWBACK FROM A DIVORCE

Authored by: Mary Young - Kingsley Napley

People get divorced for all sorts of reasons. What if the main reason for a divorce is to put assets beyond the reach of creditors? A quick divorce giving assets to the soon-to-be-ex spouse, followed by a declaration of bankruptcy can look incredibly suspicious, but if there's a Court order granting the divorce and division of assets what can be done about it?

Transfer at an undervalue

A claim for financial relief in divorce proceedings is made under Part II of the Matrimonial Causes Act 1973 ("the MCA"). Such a claim can constitute consideration within the meaning of s.339 of the Insolvency Act 1986 ("IA").

On the basis that a divorce necessarily involves people who were, until the decree absolute, married, they would be classed as associates under s 435 IA.

The ability to challenge an order in divorce proceedings on the grounds that it constitutes a transaction at an undervalue under s.339 IA therefore applies where the order is sealed less than five years before a bankruptcy petition. It is the order of the family court itself which constitutes the transaction which would need to be considered.

Such a challenge would need to be based on the idea that the order was a transaction in which the bankrupt received consideration which was worth significantly less than the value of the consideration they provided.

A careful analysis of the value of the consideration provided by each party will be necessary: not only are claims under the MCA given up, but the value of the assets should be checked, the value of liabilities considered, as well as the more ephemeral aspects of a divorce, such as the value to each party of a clean break settlement.

Is there a need to show collusion between the parties to the divorce?

Whether the abandonment of a claim for financial relief in a divorce will be classed as adequate consideration for assets received will depend on the value of the assets and liabilities being divided and on whether there are vitiating factors which include, according to the case of Hill v Haines [2008] Ch 412, collusion, fraud, concealment, mistake or misrepresentation.

The family court in Sands (as trustee in bankruptcy of Mr Tarlochan Singh) v Singh and others [2016] EWHC 636 (CH) confirmed that there were circumstances in which an order of the family Court could be set aside by a trustee in bankruptcy, but confirmed the position in Hill v Haines that there must be some vitiating factors present.

The Judge in Sands v Singh outlined a paradigm case in which an order could be set aside as one involving collusion between the spouses and said that the Court was likely to be slow to set aside an order in the absence of collusion, but also outlined circumstances in which collusion might not be necessary:

"Suppose, for example, that a husband, knowing that he was about to be served with a statutory demand and preferring his assets to benefit his wife and children than his creditors, dishonestly concealed his debts and overstated his assets so that the Court made an order in favour of the wife and children which it could never have approved had it known the true facts… If the husband were subsequently adjudged bankrupt, it might be possible for his trustee in bankruptcy to have the order set aside even though the wife had genuinely believed the husband to be as wealthy as he represented."

As such, whilst collusion was not required, some degree of fraud or concealment was necessary. This is important, as collusion could be extremely difficult to prove.

Duty of full and frank disclosure

Even where the parties to a divorce agree a division of the financial aspect of their separation, there is certain information which must be provided to the Family Court and which, in the usual course of divorce proceedings, the Court must consider to ensure the division is fair and neither party is left without a sufficient share of the assets.

The parties have an obligation of full and frank disclosure to the court to provide an accurate record of their assets and liabilities. The issue between divorcing parties usually relates to undisclosed or concealed assets, meaning one party accepts less than the amount to which they would otherwise be entitled. However, it is also possible, as envisaged in Sands v Singh that liabilities might be concealed from the Court (the Court therefore being misled and the financial position of the parties misrepresented) in order to persuade the Court to sanction a transfer of a larger proportion of assets to a receiving party, and therefore to allow those assets to remain within the family in the event of the bankruptcy of the paying party.

Further, the Court of Appeal decisions of Robinson v Robinson [1982] 1 WLR 786 and the House of Lords in Livesey (formerly Jenkins) v Jenkins [1985] 1 AC 424 confirm that a breach of the obligation of full and frank disclosure renders a consent order in divorce proceedings invalid and capable of being set aside. This will be the case where the order which was made was substantially different to an order which the Court would have made had full disclosure been given.

Where the failure relates, for example, to high value liabilities owed to third parties the question to be considered would be whether a judge would have made an order in the same terms had the true position, or anything like the true position in respect of liabilities, been disclosed.

The effect of the Order being set aside

Under s.339 of the Act an order could be sought restoring the position to what it would have been had an order of the family Court not been made. A similar position would be reached if it was found that there had been a breach of the duty of full and frank disclosure. Either case would involve assets being transferred back to the bankrupt and vesting in the trustee, therefore being used to pay creditors other than a spouse.

The impact of this in circumstances in which the liabilities outweigh the assets could be disastrous for a spouse, leaving little to nothing for financial maintenance or settlement.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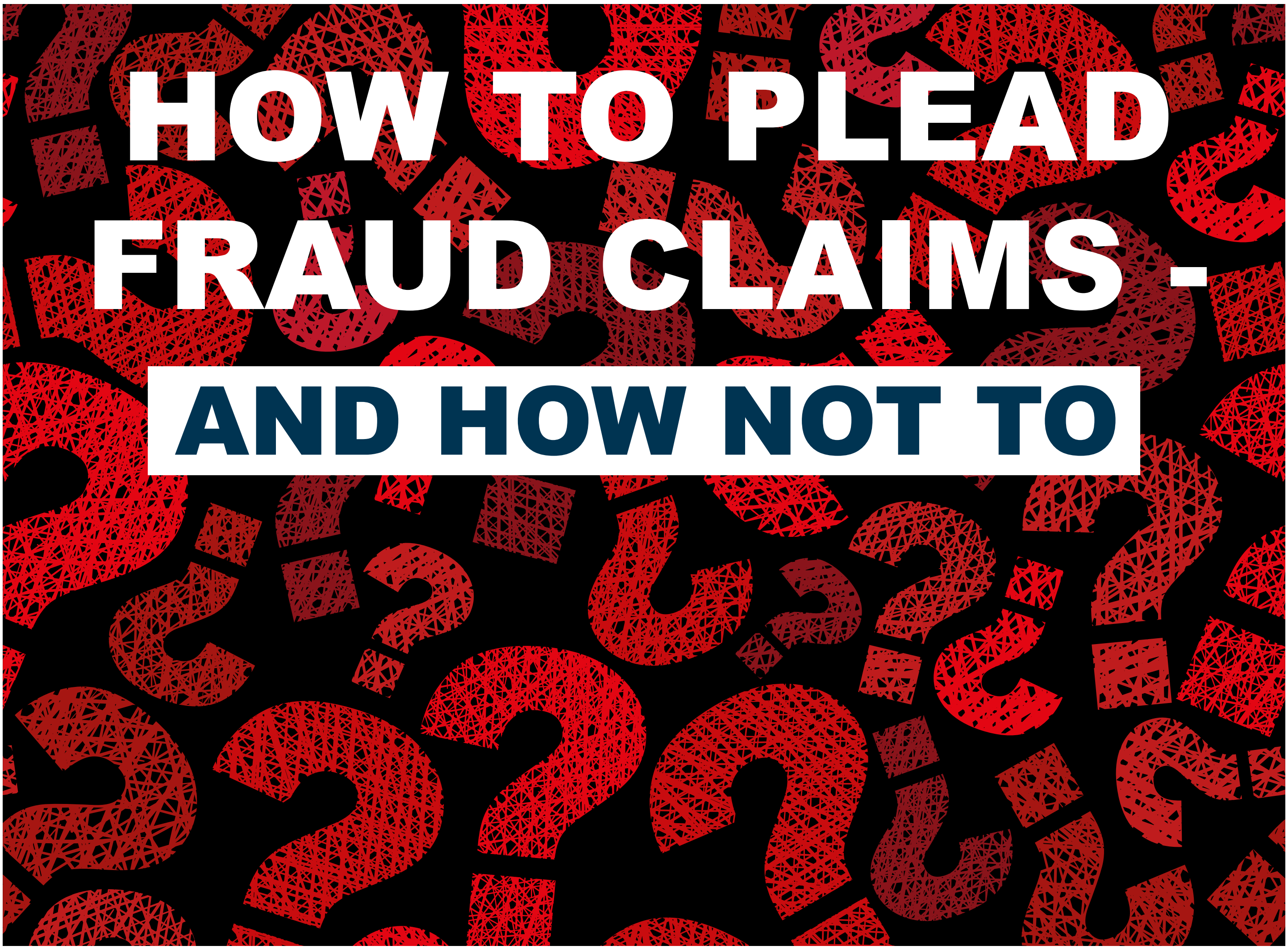
HOW TO PLEAD FRAUD CLAIMS - AND HOW NOT TO



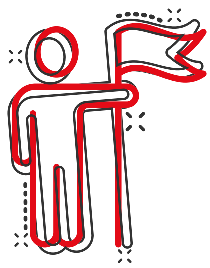
Authored by: James Popperwell, Ed Llewelyn-Evans and Alex Douty – Macfarlanes

In the recent case of King and ors v Stiefel and ors [2021] EWHC 1045 (Comm), the court struck out a claim alleging unlawful means conspiracy.

The judge, Mrs Justice Cockerill, was critical of the approach adopted by the Claimants and her judgment contains important lessons for parties seeking to bring claims for conspiracy, or for fraud more generally, and on how such claims should be pleaded.

The complexity of most fraud claims makes it relatively unusual for them to be dismissed at an interim stage on a summary judgment/strike-out basis. A full trial is often required to ensure that there is a sufficient review of the evidence. However, the 489-paragraph judgment in this case shows that the Commercial Court is willing to grapple with the detail where it is appropriate to do so and to use its power to dismiss a claim at an early stage when the claimants are unable to plead a coherent claim or a complete cause of action.

The case is also a good example of issues that can occur where parties seek to bring multiple related claims arising out of the same set of facts.

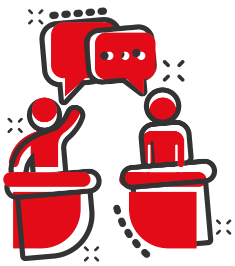


The claims made by the Claimants

The allegations of conspiracy were wide-ranging and, as the judge said, the claim "defie[d] any powers of precis". However, in very broad outline, the proceedings arose out of an earlier misrepresentation claim (the Misrepresentation Claim) brought by the Claimants but discontinued during trial. The Claimants subsequently brought a further claim against the Defendants to the Misrepresentation Claim (the first to fourth Defendants in these proceedings) and a number of their legal advisers in the Misrepresentation Claim (the fifth to tenth Defendants in these proceedings).

The Claimants alleged that the Defendants in these proceedings had conspired to enter into hidden contingency agreements, produce fraudulent costs statements and engage in threatening conduct intended to influence the Claimants and their legal representatives in their conduct of the Misrepresentation Claim. The alleged aims of the conspiracy were (i) to intimidate the Claimants and their legal advisers into discontinuing the Misrepresentation Claim (which the Claimants said would otherwise have succeeded); and (ii) to obtain the Claimants' shares in a company at less than fair value.

The judge granted the Defendants' applications to strike out and/or grant summary judgment, saying that the claim pursued at the hearing by the Claimants was "structurally fatally flawed, abusive and lacking in pleadable substance".



Pleading fraud claims

The judge identified the following three main purposes of statements of case:

1. **to enable the other side to know the case it has to meet;**
2. **to ensure that the parties can properly prepare for trial; and**
3. **to provide a "critical audit for the claimant and its legal team that it has a complete cause of action or defence."**

The judge added that a claimant's particulars should set out the essential facts which make up each key element of the cause of action as clearly and concisely as possible. In contrast, the Claimants' particulars in this case were, in the judge's words, "profoundly unsatisfactory in a number of respects." At one point, the judge said that the "pleading is unclear in the extreme, and combines tendentiousness with a combination of oversupply of evidence and undersupply of proper particulars." She also drew a comparison between the particulars in this case and those in a previous case where Briggs LJ said that the particulars came across as a "rambling narrative …, serving no apparent purpose, and obscuring, rather than clarifying, the claimant's own case".

This type of approach is particularly problematic in fraud claims because the rules require that the details of any allegation of fraud should be specifically pleaded. Legal advisers are under a professional obligation not to plead fraud unless they are satisfied that there is material to support such a claim. In this case, the judge expressed concern that a number of allegations had been pursued despite the fact that they appeared to lack "basis".

Inference in fraud claims

At the hearing, the Claimants relied on certain threats that the Defendants were alleged to have made, not as evidence to support the Claimants' primary case but because they said that it could be inferred from the making of these alleged threats that other threats had been made. These other threats, they asserted, did support their primary case.

The judge accepted that facts in support of an allegation of fraud have to be viewed "cumulatively" and that, where certain statements are shown to be untrue, it can be inferred that other statements are also untrue. However, "[t]hat does not mean that an inference of fraud can be justified by lumping together a number of disparate allegations which bear no relation to the conspiracy, fraud or deceit which is said to sound in damages". She added, by way of example:

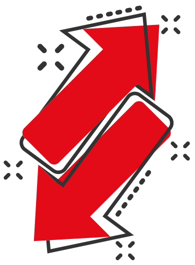
One cannot ask the court to infer fraud against A in relation to a particular transaction because (for example) he once stole a sweet from a shop, or because he lied to get out of an unwanted dinner engagement.

More generally, the judge appeared to have taken the view that the Claimants and their legal advisers were too quick to infer fraud, describing them as adopting a "hair-trigger" approach. She cited a number of examples of fraud being alleged where an innocent explanation was more likely. This resulted in "a huge amount of circular reasoning" in that allegations of dishonesty were based on the assumption that there was a conspiracy. The judge commented:

Thus the desire to allege fraud/dishonesty/ conspiracy becomes a kind of philosopher's stone which transforms innocent errors into dishonest conspiracies - from which in turn the main conspiracy can itself be inferred.

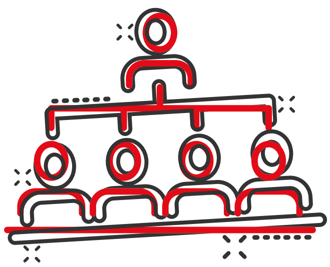
Disclosure

Some elements of the Claimants' particulars in this case were said to be "pending disclosure." Disclosure is an important feature of litigation in England & Wales that can result in parties obtaining documents to support their case. However, the judge made it clear that it is not permissible to avoid the need for giving particulars by saying that particulars will be given at a later stage. A party alleging misconduct must give particulars before obtaining disclosure. Or, as the judge said elsewhere in her judgment, "when faced with a summary judgment application it is not enough to say, with Mr Micawber, that something may turn up".



Amendments

A further problem with the Claimants' particulars in this case was that, by the time of the hearing, their case had substantially changed but their particulars had not been amended to reflect this. Whilst the judge was, in this case, willing to consider the unpleaded aspects of the claim to "ensure the [Claimants] understand that the case they advance has been considered", she also said that "[s]trictly speaking it would probably be right to proceed only on the basis of the pleaded case". It is common for fraud claims to evolve as different lines of enquiry are pursued. However, it is important that claimants amend their particulars of claim to reflect developments. Otherwise, they risk being precluded from advancing arguments that they wish to make.



Multiple disputes

It is not unusual for complex commercial disputes to give rise to a series of separate sets of proceedings raising different issues and between similar and/or different parties. This dispute is a good example of this. The judge referred to a number of other disputes between the parties and said that the Misrepresentation Claim had given rise to "a multiplicity of litigation which must inevitably put any observer with a taste for nineteenth century fiction in mind of the infamous Jarndyce case."

Parties who find themselves fighting on several "fronts" in this way should be aware that arguments that they raise (or should raise) in one set of proceedings can have a significant impact on other related litigation. For example, in this case the judge found:

- certain elements of the claim in this case were inconsistent with the professional negligence claim, which the Claimants have brought against the legal advisers who acted for them in the Misrepresentation Claim. That undermined the Claimants' position in this case;
- it was an abuse of process for the Claimants to try to run arguments in these proceedings, which could and should have been raised in the detailed assessment proceedings arising out of the Misrepresentation Claim. A claim may comprise an abuse of process as amounting to an attempt to relitigate a point which was or should have been raised in earlier proceedings, even if the parties to the second set of proceedings are not identical to those in the first set of proceedings; and
- it was an abuse of process for the Claimants to argue that they "would have won" the Misrepresentation Claim, if (allegedly) an unlawful means conspiracy had not caused them to discontinue those proceedings. In reaching this conclusion, the judge clarified that the rules on abuse of process are engaged where there has been a discontinuance (and not just where there has been a judgment or settlement in the earlier proceedings).

These findings demonstrate the necessity for claimants seeking to bring multiple related sets of proceedings (whether concurrently or successively) to ensure that their claims are consistent with one another. Parties who wish to delay bringing parts of their claim should draw this to the attention of the court and the other side in accordance with the guidelines in Aldi Stores Ltd v WSP Group plc [2007] EWCA Civ 1260 to reduce the risk that the later proceedings will be found to be an abuse of process. Judges are more likely to endorse this approach if they can be persuaded that there are sensible case management reasons for delaying claims (or parts of claims) than if they take the view (as happened in this case) that claimants have decided not to run relevant arguments for tactical reasons. If parties consider that a judgment is wrong, they should appeal that decision, rather than trying to re-run the same or similar arguments in another set of proceedings. Parties who discontinue claims should be aware of the risk that an attempt to resurrect the same or similar claims in later proceedings may be regarded as an abuse of process.

Conclusion

The judge noted that the Claimants in this case had a "passionate belief in the merits of this claim". This is a common feature of fraud claims, where allegations of dishonesty can cause tensions to run high on all sides. It is also common for fraud claims to be factually complex and claimants often have to grapple with the problem that perpetrators of a fraud (if there has been one) will have taken steps to cover up their actions.

These features increase the importance for parties and their legal advisers to adopt a measured and precise approach – despite the fact that there is often a strong temptation to do otherwise. In particular, it is vital that claimants take care to identify and plead all aspects of their cause of action and to ensure that there is sufficient material to justify allegations of dishonesty.

Ultimately, in this case, the Claimants' claim failed because they had not pleaded, and could not identify, a complete cause of action.

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