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Defeating dissipation: recent legal developments

JON FELCE

PCB LITIGATION LLP

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When disputes arise and lead to proceedings, the first instinct might often be to focus on securing a favourable judgment. However, that is often only half of the story. There is no guarantee that a judgment debtor will pay, and in the fraud arena it is often the case that defendants will do everything they can to avoid satisfying their liabilities to claimants. What is the solution? Primarily, the answer is twofold. Firstly, putting in place a well-considered and creative strategy before proceedings are launched, and secondly using the tools available – and establishing new tools – to preserve and enforce against assets. As set out below, the two frequently go hand-in-hand. This article therefore looks at developments in relation to freezing orders, contempt of court, new causes of action, the use of insolvency procedures and enforcement.

In fraud cases in particular, claimants have an array of armoury at their disposal right from the beginning of a case, not least through the use of freezing orders which are often worldwide in nature. Recent developments

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Jon Felce is a partner at PCB Litigation LLP. He can be contacted on +44 (0)20 7831 2691 or by email: jf@pcblitigation.com.

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in this arena have been a welcome addition to this critical tool in the fight against fraudsters.

A primary benefit of a freezing order is that it restrains defendants from illegitimately dealing with and dissipating assets. One recent case has confirmed that there is also jurisdiction to impose a reporting procedure to enable asset dealings to be monitored, the so-called 'notification injunction' (*Candy v Holyoake* (2017)). Such an order can enable a claimant to keep abreast of intended transactions so that appropriate steps can be taken if any potential transactions might be illegitimate.

A second principal benefit of a freezing order is that it requires defendants to disclose assets. But what assets? This question is being increasingly grappled with, and it is apparent that the legal system is adept at developing solutions to the sophisticated techniques used by fraudsters to disassociate themselves from assets. In particular, there has been a movement away from the traditional approach of solely considering whether a respondent owns an asset legally or beneficially.

Key now also is whether or not the respondent controls an asset. For example, in late 2017, a court confirmed that a freezing order could extend to the assets of a (legally separate) company in which the respondent is a sole shareholder (*BM-Bank JSC v Chernyakov* (2017)). This followed a raft of recent decisions, including that injunctions can extend to property apparently held by the respondent as a trustee or nominee and to interests under a discretionary trust (*JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* (2015)).

Such developments allow claimants to police freezing orders with greater effect to seek to prevent asset dissipation. Frequently, asset disclosure orders are coupled with orders restraining defendants' travel and for the delivery up of their passports. These are designed to encourage compliance with asset disclosure by seeking to secure a respondent's presence in the jurisdiction. If a respondent fails to comply with a freezing order, he or she then risks being committed to prison for contempt of court.

The power of the contempt regime is not confined to freezing orders, but also extends to the insolvency context which, as set out below, is an increasingly attractive means of pursuing assets. Indeed, in one recent case (*Simmonds v Pearce* (2017)), an 83-year-old bankrupt who had taken steps to make it difficult to trace and recover money was sentenced to 12 months' imprisonment.

Committal is also available in relation to misconduct during a case itself. In another recent case, a businessman was sentenced to 12 months for bringing a fraudulent claim based upon a forgery and false evidence (*Patel v Patel* (2017)). Such cases are symptomatic of the increasing use of committal during disputes. The purpose of committal is not just to punish contemnors but to seek to encourage compliance with court orders. The growing prevalence of not just committal proceedings but longer prison sentences for contempt of Court sends a strong message to potential miscreants. Indeed, in the aforementioned *Chernyakov* case, the defendant was given a rare maximum prison sentence of two years. For similar reasons, private criminal prosecutions have become more frequent for cases traditionally fought out solely in the civil arena.

Developments designed to clamp down on fraud have not been confined to freezing orders and committal. Indeed, there has been

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an array of recent cases seeking to establish new bases on which claims may be advanced. This has primarily involved tackling attempts by debtors and their affiliates to dissipate assets.

In one case (*Marex Financial Ltd v Garcia* (2017)), a claimant obtained a multimillion-dollar judgment against two companies and a post-judgment freezing order. After asset disclosure by the companies revealed that the companies' assets were minimal, the claimant stated that the companies' alleged beneficial owner and controller had stripped the companies of assets following receipt of a draft of the judgment. The claimant launched proceedings against him, alleging that in asset stripping the companies he had committed a tort of knowingly inducing the companies to act in wrongful violation of the claimant's rights under its judgment. When determining whether it had jurisdiction to hear the claim, the court held that there was a good argument that such a tort exists. An appeal is due to be heard in June 2018.

In another case (*Khrapunov v JSC BTA Bank* (2017)), it was alleged that a judgment debtor engaged in an unlawful means conspiracy with one of his relatives by conspiring to prevent the claimant from enforcing its judgments. An unlawful means conspiracy is when two or more people act together unlawfully with the intention of damaging a third party, and do so. The alleged unlawful means in this case involved dealings with assets in breach of freezing and receivership orders. At both first instance and on appeal, the court concluded that it was possible to pursue a claim for unlawful means conspiracy in circumstances where the only unlawful act alleged involved breaches of court orders. This case is now being heard in the Supreme Court of England and Wales as of January 2018.

The nature of the unlawful means in an alleged conspiracy was also considered in another recent case (*Gerald Metals v Timis* (2017)). In that instance, the court concluded at an interlocutory hearing that there was a good arguable case that a transaction in respect of which an order may be made under section 423 of the Insolvency Act 1986 (which concerns transactions defrauding creditors) can be unlawful means for the purpose of the tort of unlawful means conspiracy.

This case is also indicative of another increasing trend, namely the use of section 423. Although this provision can be found within insolvency legislation, it entitles not just insolvency practitioners but 'victims' also to pursue defendants. The section applies where there has been a transaction at an undervalue for the purpose of putting assets beyond the reach of potential or actual creditors, or otherwise prejudicing the interests of such a person in relation to a claim which they are making or may make. The relief granted can include the making of orders restoring the position to what it would have been if the transaction had not been entered into and protecting the interests of the victims of the transaction. Two recent cases will be of particular interest to company directors. One determined that the payment of a dividend to shareholders (even if lawful under companies legislation) can be a transaction at an undervalue and one defrauding creditors and therefore within the ambit of section 423 (*BTI 2014 LLC v Sequana* (2016)). In another case, the same was found to apply to a share buyback by a company (*Dickinson v NAL Realisations (Staffordshire) Ltd* (2017)).

The increasing pursuit of section 423 claims is consistent with the wider trend of using insolvency powers in a fraud context. This

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need not be confined to domestic insolvencies. A number of high-profile insolvencies have utilised the cross-border insolvency regime to advance recovery efforts, including recently in the case of the so-called 'Chilean Madoff', Alberto Chang Rajii. The legislation entitles permit office holders to seek recognition in multiple countries and thus benefit from a range of powers across jurisdictions to assist the investigation and realisation of assets.

As for the realisation of assets, enforcement itself has also been an arena in which new developments have added to the weaponry available to claimants in the fight against fraud. The last year or so has seen a number of groundbreaking decisions, not least in the aforementioned *Chernyakov* case. Here the claimant obtained an order entitling it to image and search electronic devices for information on assets. That order was obtained without notice to the defendants and others claiming that the devices belonged to them, and the first three months of the review exercise similarly took place without notice to these individuals. Once the imaging had occurred, the claimant obtained an unprecedented order permitting software to be run to 'crack' password-protected documents to enable their review. Meanwhile, in another case, the court confirmed the existence of the jurisdiction to grant a search order – one of the law's so-called two nuclear weapons – against a third party (*Abela v Baadarani* (2017)).

These decisions – and those outlined elsewhere in this article – serve to emphasise that the increasing creativity and sophistication of fraudsters is being matched if not outdone by the legal profession. ■

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