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FIRE *MAGAZINE*

Fraud • Insolvency • Recovery • Enforcement

ISSUE 15

FIRE MAGAZINE YEAR IN REVIEW 2023

TURNING THE PAGES ON A YEAR OF CHALLENGES AND VICTORIES FOR FRAUD, INSOLVENCY, ASSET RECOVERY, AND ENFORCEMENT

INTRODUCTION

"Follow effective action with quiet reflection. From the quiet reflection will come even more effective action."

Peter F. Drucker

As we draw to the end of another fantastic year, we are pleased to publish the final FIRE Magazine for 2023, our 'Year in Review' edition. Inside Issue 15, our authors tackle a variety of topics that have been prominent this year, including the use of AI in asset recovery, the tightening of Court's control of office-holders, and of course the year of Barbie! This issue also features a **Women in FIRE Supplement**, where we feature a series of 60 seconds with interviews alongside further insightful content, all curated by just some of our incredible Women in FIRE.

We extend our deepest gratitude to all our Community Partners and contributors whose expertise and commitment have been instrumental in shaping all the issues for 2023. Your valuable insights and knowledge sharing have enriched the pages of the FIRE Magazine. We look forward to bringing you more in 2024.

The ThoughtLeaders4 FIRE Team

Paul Barford
Founder/Managing Director
0203 398 8510
email Paul

Chris Leese
Founder/Chief Commercial Officer
0203 398 8554
email Chris

Danushka De Alwis
Founder/Chief Operating Officer
020 7101 4191
email Danushka

Maddi Briggs
Strategic Partnership Senior Manager
020 3398 8545
email Maddi

Yelda Ismail
Senior Marketing Manager
020 3398 8551
email Yelda

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Women in FIRE

Women in FIRE Supplement

CONTRIBUTORS

Sean McGuiness, **Omni Bridgeway**

Tristan Yelland, **Grant Thornton**

James Hyne, **Charles Russell Speechlys**

Carris Peacey, **Charles Russell Speechlys**

Quentin Bregg, **Collas Crill**

Daisy Bovingdon, **Collas Crill**

Alaric Watson, **Gatehouse Chambers**

Eoin Maclachlan, **Maitland Chambers**

Alice Court, **Irwin Mitchell**

Jessica Powers, **New Square Chambers**

Amy Harvey, **Ontier**

Sumru Akter, **Omni Bridgeway**

Nour Khaleq, **Ogier**

Jessica Brooke, **Wilberforce Chambers**

Sarah Twohig, **Pinsent Masons**

Laura Webster, **New Square Chambers**

Elizabeth Ross, **Kroll**

Liz Jones KC, **Serle Court**

FIRE

Upcoming Events

Sovereign & States Disputes and Enforcement Summit 2024

6th - 7th February 2024 | The Law Society

FIRE Starters Global Summit: Dublin

21st – 23rd February 2024 | Conrad Hotel, Dublin

FIRE International: Vilamoura

15th – 17th May 2024 | Anantara Hotel, Vilamoura

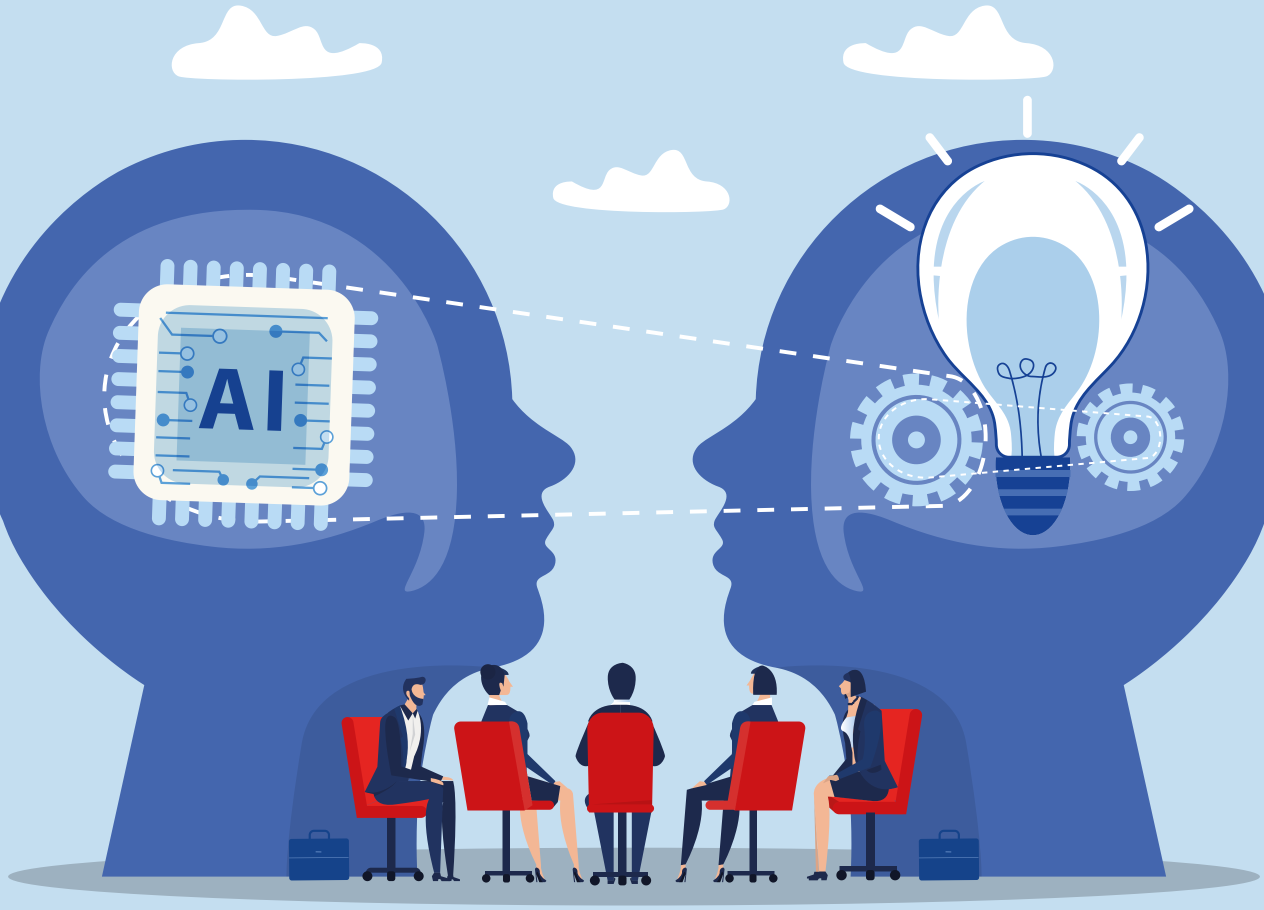
FIRE Americas: Cayman

5th - 7th June 2024 | The Westin, Grand Cayman

To register for the events and speaking opportunities contact:

Paul Barford
Founder/Director
T: +44 (0) 20 3398 8510
E: paul@thoughtleaders4.com

RISE OF THE MACHINES



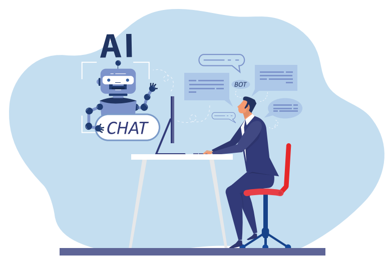
AI AND OTHER TECHNOLOGIES IN INTERNATIONAL ASSET RECOVERY

Authored by: Sean McGuiness (Investment Manager) - Omni Bridgeway

New technologies are playing an increasingly important role in international asset recovery, allowing professionals to track and recover assets more efficiently and effectively across borders.

Two distinct technologies that are ever more relevant are artificial intelligence (AI) and blockchain. For years now, it has been necessary for asset recovery practitioners to be familiar with blockchain as the rise of crypto has led to significant assets being held in crypto wallets. 2023 has seen a continuation of the use of blockchain in recovering assets on behalf of victims of crime and fraud, with collaboration across investigators and state bodies leading to large recoveries and setting precedent for crypto to be recovered and converted to fiat.

Before 2023 it was less obvious that those in the asset recovery sector should also have a solid grasp of how to leverage AI. With the launch of high-profile large language models in 2023 encouraging business leaders across all sectors to understand how AI can assist, asset recovery is no exception. The immediate applications of AI are obvious to those with an understanding of how AI works. Investigators and office holders are often faced with enormous, incomplete and unorganized data sets when seeking to understand how and when a fraud has been committed, who was involved and, crucially, where any dissipated assets have gone. AI can quickly assist in analysing large and complex data sets to identify suspicious transactions, fraud and key evidence allowing claims to be developed and brought quickly.



AI on FIRE

Asset recovery is a complex and challenging field, by definition, multi-jurisdictional and multi-disciplinary. FIRE (fraud, insolvency, recovery and enforcement) professionals rely on knowledge of local laws, customs, trends and financial structures in making recoveries. In 2023 headlines have been dominated by the rise of generative AI, driven by the growth of models such as Google's "Bard" and Open AI's various iterations of "Chat GPT". AI can and is being used to enhance and augment industry knowledge and experience to drive more efficient recoveries. Whilst generative AI has stolen headlines this year, earlier stages of AI can be equally relevant to FIRE practitioners. AI can help in many ways including:

1. **Pattern recognition and accounting analysis:** AI can be used to identify patterns in data that may indicate fraud, including unusual and uncommercial transactions, discrepancies in revenue or expense accounts, the creation of fictitious assets, or the manipulation of accounting ratios.
2. **Anomaly detection:** AI can be used to detect anomalies in data, which deviate significantly from the norm, including transactions or communications with counterparties that are unusual or suspicious.
3. **Uncovering hidden relationships and networks:** Hidden relationships and networks between individuals involved in the company's operations may reveal undisclosed connections or potential collusion in fraudulent activities. AI could identify individuals who control multiple entities, trace the flow of funds through complex networks, or uncover hidden ownership structures.

At the investigation stage, AI can efficiently and quickly review large data sets including financial transactions, communications and corporate documents, and can save time compared to pure manual exercises, particularly across large complex fraud investigations involving multiple jurisdictions. This can help asset recovery professionals identify and recover assets more efficiently and effectively, augmenting existing expertise. Depending on how and where data is stored and reviewed, and how the AI is trained, AI can also 'learn' through each investigation, becoming better at identifying patterns each time.

These techniques and practices are all familiar to FIRE practitioners. The primary use case is therefore to augment existing practices to analyse data in a more efficient manner. This may also lead to more efficient settlement and recoveries as the shape of fraud can be better understood, key incriminating evidence can be identified quicker, and asset dissipation can be understood in a more comprehensive manner.

It is rare that private investigations are made public and so it is difficult to understand how widely AI is already being used. As a public example, in 2023, the Australian Federal Police ("AFP") reported that it had used AI to analyse data obtained under warrant, stating that the use of AI – primarily large language models – sped up the discovery task, and allowed the team to find useful information within large data sets. The AFP said the use of AI and large language models could help analyse transactional data to identify irregular patterns like money laundering and potential fraud, allowing decisions to be made more effectively.

This is not however the end of days. Crucially, FIRE practitioners will need to have a working understanding of how the underlying AI works to ensure that they are complying with local and cross-border laws and regulations.

AI should therefore act as a complement, not a substitute, for FIRE practitioners.

I can still hear you sayin', you would never break the chain

In previous years FIRE practitioners have been skeptical about the ability to recover assets through the use of blockchain. With the increasing and well documented use of blockchain and cryptocurrency to attempt to move assets out of reach, partnership between recovery and blockchain experts is increasingly necessary.

There have now been a number of successes, including most recently in 2023 a reported case of the UK police working together with the Kraken crypto exchange in an investigation and recovery exercise where, for the first time, police and the Financial Conduct Authority (FCA) worked with Kraken to recover, and then convert, crypto assets. This investigation resulted in the prosecution of an individual who had transferred more than EUR 10 million of tokens to various cryptocurrency trading accounts, out of the reach of unsuspecting investors.

In the investigation and subsequent enforcement action, over GBP 2 million of crypto was recovered from the exchange with the assistance of Kraken, before being converted into GBP to allow recovered funds to be distributed to around 60 individuals globally in a lawful and transparent process.

This is only a recent example of the type of collaboration across the asset recovery community that we can expect to see in the future, leveraging expertise and technology together to recover on behalf of claimants. It is also a useful recent touchpoint for FIRE practitioners to cite when skeptics argue that recovery professionals might never break the chain.

Conclusions

The pace of change in technologies means that investigations and recovery efforts today look very different to even ten years ago. This change is allowing recovery practitioners to become more effective, bridging a gap that has existed for a long time where fraudsters and wrongdoers held the upper hand with an ability to move quickly and hide information amongst large data sets, whereas asset recovery professionals had their work slowed down by intensive manual investigations and relatively slow asset tracing.

The future will look very different. AI has only scratched the surface and, as it continues to be utilized, will improve over time to the point it will in all likelihood become a fundamental bedrock of investigations and asset recovery work. Efforts on the blockchain are bearing fruit, showing that it can be utilized by recovery professionals to positive effect.

Learning to harness these technologies will ensure practitioners can continue to advance the profession in the years to come.

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Visit grantthornton.co.uk to find out more, or contact one of our insolvency and asset recovery partners:

Kevin Hellard
Practice Leader
T +44 (0)20 7865 2478
E kevin.hellard@uk.gt.com

Amaechi Nsofor
Partner
T +44 (0)20 7865 2388
E amaechi.nsofor@uk.gt.com

Hannah Davie
Partner
Estates and Family Disputes
T +44 (0)20 7865 2849
E hannah.davie@uk.gt.com

Colin Diss
Partner
T +44 (0)20 7865 2511
E colin.diss@uk.gt.com

Hugh Dickson
Partner
T +1 345 769 7203
E hugh.dickson@uk.gt.com

Margot MacInnis
Partner
T +1 345 769 7203
E margot.macInnis@uk.gt.com

Nick Wood
Partner
T +44 (0)20 7728 2426
E nick.s.wood@uk.gt.com

David Bennet
Partner
T +1 284 346 9975
E david.bennett@uk.gt.com

Nick Nicholson
Partner
T +44 (0)20 7184 4352
E Nick.W.Nicholson@uk.gt.com

Prashan Patel
Partner
T +44 (0)20 7865 2328
E prashan.p.patel@uk.gt.com

John Skelton
Partner
T +44 (0)20 7728 2039
E John.G.Skelton@uk.gt.com

Robert Starkins
Partner
T +44 (0)20 7728 2132
E Robert.N.Starkins@uk.gt.com

Grant Thornton

DS3180

Authored by: Tristan Yelland (Director) - Grant Thornton

2023 was the year of Barbie. Drenched in pink (the film is reported to have exhausted its suppliers' stock of pink paint) the film received widespread critical acclaim, broke all manner of box-office records and led to a 25% increase in Barbie toy sales.

However, of the many millions of people who queued up to watch the film, it is likely that few (if any) would have drawn parallels between the struggles experienced by Barbie and Ken in the film and the ongoing struggle to enact much needed reforms of corporate governance and the audit profession, which suffered further setbacks in 2023. But the parallels are clear to see…

An existential crisis

One of the key themes of the Barbie film is change, as (spoiler alert) Barbie suffers an existential crisis and subsequently embarks on a journey of self-discovery. Like Barbie, the UK's audit and corporate governance regime has suffered an existential crisis in recent years, following a series of high-profile corporate collapses and accompanying concerns over the quality of their audits.

This led to the Kingman and Brydon reviews in 2018, which proposed a series of reforms to the UK's audit profession and the corporate governance rules for large companies.

Many of the proposed reforms were designed to strengthen procedures in respect of suspected frauds:

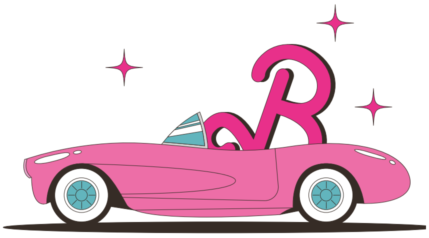
1. Directors of Public Interest Entities would be required to report on the steps they had taken to prevent and detect fraud;
2. Auditors would be required to report on the steps they had taken to conclude that this disclosure by the directors was accurate; and
3. A record of corporate frauds be maintained by a new and more powerful regulator, which would replace the Financial Reporting Council (FRC) – the Audit, Reporting and Governance Authority.

Further delays in 2023

However, after years of consultations with various stakeholders, in October 2023, the government shelved its plans for the corporate reporting regulations, citing concerns raised by companies regarding the costs of complying with them. Audit reforms were also a notable omission from the legislative package that was set out in the King's speech in November 2023.

These delays have created uncertainty in the audit profession and will likely hinder efforts to enhance corporate transparency and address concerns about the quality of audits.

Although the government has publicly stated that it remains committed to corporate governance and audit reform, its absence from the King's Speech means that there will be no legislative progress until after the general election in 2024. It is now widely predicted that the new regulator will not be in place before 2027[1].



Better news thanks to ISA (UK) 240

Despite the legislative delays, 2023 did see positive developments in respect of auditors' duties in relation to fraud. This was largely thanks to the impact of the FRC's revisions to ISA (UK) 240.

ISA (UK) 240, or the International Standard on Auditing (UK) 240, sets out the auditor's responsibility to consider fraud in an audit of financial statements. A revised version of the standard took effect on 15 December 2021: While responsibility for the detection and prevention of fraud remains firmly with management, the changes to the standard were aimed at addressing concerns that auditors weren't doing enough to detect fraudulent misstatements in company accounts.

Key updates included:

1. Placing a greater emphasis on the need for auditors to exercise professional skepticism;
2. Enhancing the requirements relating to auditors' risk assessment procedures, so that auditors may better identify potential fraud risks, document their considerations of such risks and their responses to them; and
3. Making it a requirement for the audit team to consider whether specialist skills are needed at both the risk assessment stage and the audit testing stage. The revised standard specifically mentions the use forensic accounting experts in this regard.

After the revisions to the standard took effect at the end of 2021, we saw a material change in the way in which many auditors approached their work in 2022 and this is a trend that continued in 2023: As forensic accountants we now regularly assist audit teams in conducting more thorough risk assessments at the outset of audits, using our expertise to identify red flags and patterns that may indicate potential fraud and helping auditors tailor their audit procedures accordingly.

More input from forensic accountants and lawyers

In cases where the audit team does identify potential fraud during the course of its audit testing, we have seen that independent forensic accountants are increasingly being brought in by management to conduct detailed investigations, in response to challenge from the audit team. These investigations can involve interviewing individuals, gathering additional evidence and conducting a much more in-depth analysis of financial transactions than traditional audit testing methodologies would have allowed.

The involvement of forensic specialists to investigate suspected fraud has naturally also led to a greater role for legal advisers in the audit process: Lawyers who specialise in fraud and white-collar crime are increasingly being brought into the audit to advise on the investigative process and the legal implications of any findings, while ensuring that all communications remain privileged.

And so, while it may not be the wide-ranging reform that it is needed, it is clear that revisions to ISA (UK) 240 have led to greater awareness of fraud risks and more robust responses to them.

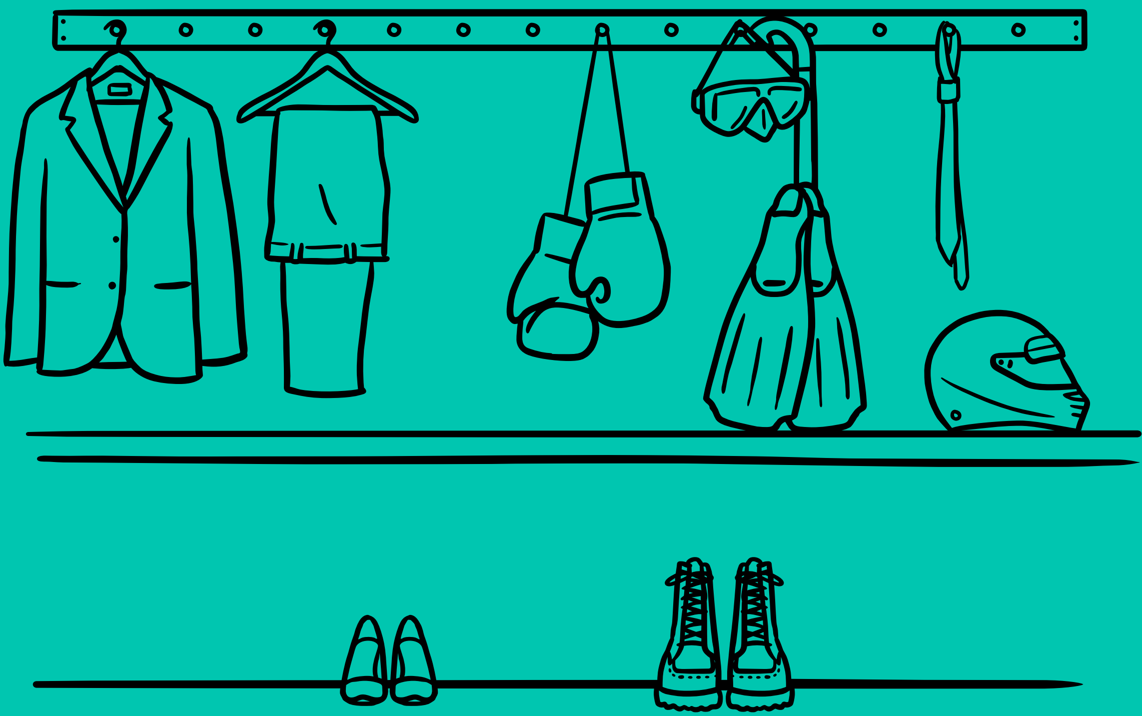
Conclusion: Barbie the auditor?

Here is another fact about Barbie – Ruth Handler, the creator of Barbie and founder of Mattel Toys (who makes a brief appearance in the film as an old lady sitting on a bench), was a real-life fraudster: In 1978, Handler and a business partner were charged by the US Securities and Exchange Commission with falsifying Mattel's accounting records between 1971 and 1973 by inflating sales in order to bolster the company's floundering share price. Facing more than four decades in prison, Handler pleaded no contest to the charges and was ordered to pay $57,000 in fines and do 2,500 hours of community service.

This may explain why – despite famously having had over 200 jobs in her career – Barbie has never been an auditor (or an SEC official!). Sadly, given the delays to audit and corporate governance reforms there may be little motivation to change that statistic any time soon.

However, while these delays are undoubtedly a setback, in 2023 we have seen enough evidence to suggest that revisions to ISA (UK) 240 have at least gone some way to clarifying the auditor's roles and objectives regarding fraud. This has led to greater professional skepticism and changes to the ways in which fraud risks have been addressed, with greater involvement from forensic and legal experts. We expect to see this trend continue into 2024.

1 https://www.ft.com/content/57d2dfd5-92d1-4cb4-ac1e-9e0cd3c2aff4



THE YEAR IN REVIEW

SCOPE OF DIRECTORS' DUTIES REVISITED

Authored by: James Hyne (Partner) and Carris Peacey (Associate) - Charles Russell Speechlys

The Supreme Court's judgment in BTI 2014 LLC v Sequana SA and ors[1] ("Sequana") is a key decision on the law surrounding directors' duties.

The High Court was required to consider the Supreme Court's Sequana judgment in Hunt v Singh (below).

What did we learn from Sequana?

In Sequana the Supreme Court confirmed that directors must consider the interests of creditors and undertake a balancing exercise with respect to the interests of shareholders when these interests are in conflict. This Creditor Duty is engaged when the directors know (or ought to know) that:

1. The company is in an actual state of insolvency;
2. There is a probability of the company entering insolvent liquidation or administration; or
3. The company is bordering on insolvency (meaning that insolvency is both imminent and inevitable).

In such circumstances, the directors must also consider the interests of the creditors in the context of a 'sliding scale'; the more dire the company's financial position, the more the directors should consider the interests of creditors (based on what they actually knew or should have known).

If insolvency is inevitable, the interests of creditors should be paramount. Conversely, a real risk of insolvency is not enough to trigger the Creditor Duty alone.

The Sequana decision is largely seen as a swing of the risk pendulum towards directors. It gives them more leeway to delay engaging with the Creditor Duty. Previously directors were expected to engage with the Creditor Duty when the company was in or approaching the fairly nebulous concept of the 'zone of insolvency'.

1 [2022] UKSC 25

Hunt v Singh

In the more recent case of Hunt v Singh [2] the Court considered the Creditor Duty in the context of whether the duty arises where a company is, in fact, insolvent, but the directors wrongly believed that the liability giving rise to the insolvency had effectively been avoided.

Hunt v Singh concerned a service company, Marylebone Warwick Balfour Management Limited (the "Company") which provided management services to its group companies. In 2002 the Company entered into a tax avoidance scheme designed to enable bonuses to be paid to the Company's senior management without incurring liabilities to HMRC for PAYE and NIC contributions (the "Scheme"). The Company's tax advisors advised the directors that the Scheme was "robust", despite the growing interest and enquiries from HMRC into the operation of the Scheme. In September 2005 the Company rejected a market-wide offer put forward by HMRC to settle the liability arising under the Scheme. HMRC consequentially notified the Company of its intention to resolve the matter through litigation and in 2010 the tax tribunals held that PAYE and NIC contributions were due on the payments paid under the Scheme. The Scheme ceased in 2010 and the Company subsequently entered liquidation in 2013.

The liquidator of the Company (Mr Hunt) brought various claims against several former directors, including claims under section 212 of the Insolvency Act for breach of the Creditor Duty, for allowing payments to be made at a point where the Company was already insolvent. The claims were dismissed at first instance in the Insolvency and Companies Court and the liquidator's appeal against Mr Singh was heard in June 2023.

What did the Court decide?

On appeal, Mr Justice Zacaroli considered the differing context of the case before him, when compared with the facts of Sequana.

In Sequana, the company was solvent at the time the relevant dividends were paid. The question in that case was whether the company's directors ought to have realised that the company was likely to become insolvent on account of a contingent liability of an unknown amount. However, in Hunt v Singh, the Company was actually (and substantially) insolvent throughout the relevant period. The fact that the Company disputed the liability to HMRC did not change the fact that it was a liability (admittedly subject to a legal challenge that would have expunged the debt had the challenge been successful). A disputed liability was not a contingent liability.

At first instance, Judge Prentis held that the Creditor Duty was not engaged because the directors had acted reasonably in taking and acting upon advice around the merits of HMRC's claim.

Mr Justice Zacaroli found that Judge Prentis had applied the wrong test to determine when the Creditor Duty arose.

The correct test was that where the Company's solvency was dependent on it successfully challenging HMRC's claim, the Creditor Duty was triggered if the directors "knew or ought to have known that there is at least a real prospect of the challenge failing".[3]

Mr Justice Zacaroli recognised that the Supreme Court rejected this test in Sequana, but noted that, in Sequana, the Supreme Court had been examining a company that was solvent at the time the duty had allegedly arisen. In the current case, the Company was insolvent and therefore the appropriate test was one of "real risk". As Mr Justice Zacaroli explained, the difference between the two contexts is clear when one considers the rationale for the Creditor Duty: the shift in the economic interest from shareholders to creditors. If, as in the circumstances of Hunt v Singh, it turned out that the Company was insolvent at the relevant time, then this shift in economic interest had already happened.

On the facts, the High Court in Hunt v Singh found that Mr Singh had become aware of the risk in September 2005 (when HMRC made its market-wide offer). The Creditor Duty had therefore arisen at that point and continued up to the Company's liquidation in 2013. Mr Justice Zacaroli declined to consider whether or not Mr Singh had in fact been in breach of the Creditor Duty. Since the Sequana judgment had been handed down between the hearing of Hunt v Singh at first instance and the appeal, Zacaroli considered that further findings of fact may need to be made in line with the guidance of the Supreme Court, and accordingly remitted the case to be reconsidered.

Differences between Wrongful Trading and the Creditor Duty

The duties in respect of Wrongful Trading and the Creditors Duty are not the same. The Sequana judgment held that there was no conflict between the Creditor Duty and the wrongful trading provisions found in s.214 of the Insolvency Act. When the Creditor Duty is triggered, directors have a duty to act in the best interests of the company generally. Wrongful Trading encompasses a duty to take reasonable

2 [2023] EWHC 1784 (Ch)

3 [2023] EWHC 1784 (Ch) paragraph 51

care to minimise the potential loss to the company's creditors when the directors knew or ought to have concluded that there was no reasonable prospect of avoiding insolvency.

The key message for directors

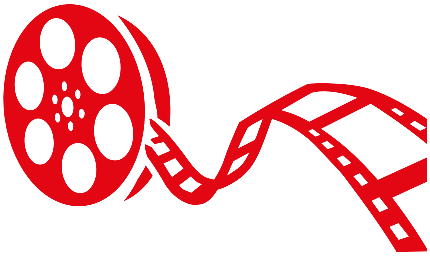
The decision in Hunt v Singh should be treated with a degree of caution.

The key question as to whether the directors of a company need to know that a company is insolvent or bordering on insolvency for the duty to arise was not argued before the court.

The Court took an explicitly different approach from the Supreme Court in Sequana. It is not possible to know whether the Supreme Court would have taken the same view in this instance.

Following Hunt v Singh, once directors become aware of a disputed liability that would push their company into balance sheet insolvency, if the claim against the company were to be successful, they must consider the likelihood of the liability crystallising and the potential consequences. The test to bear in mind is whether the directors know or ought to know that there is at least a real prospect of the challenge to the liability failing. This is a low bar, and ought to be at the forefront of directors' minds when considering liabilities and litigation of significant value.

The difficult question is when directors become aware of a potential liability. What is clear from both Hunt v Singh and Sequana is that the duty arises at the very least if a "reasonably diligent and competent director" would know that there is no reasonable prospect of avoiding insolvency proceedings. Where the line is drawn prior to that will be fact specific on the directors' knowledge and depend on the nature of the liability in question (contingent versus disputed). A reasonably diligent and competent director ought to ensure legal advice is sought and followed on significant disputed liabilities.



Carillion - missed opportunity or a case that should never have been brought?

As a footnote to the above, it is worth noting the Insolvency Service's disqualification proceedings against the non-executive directors ('NEDs') of Carillion Plc have been dropped at the eleventh hour. The discontinued proceedings were a test case in relation to the five former NEDs and was listed for a 13 week trial to run from mid-October.

The case against them was one of unfitness pursuant to s.6 of the Company Directors Disqualification Act 1986 on the basis that they did not know the true financial position of the company and allowed misstatements in the accounts to be signed off.

Had the case proceeded and the NEDs been found liable and disqualified, notwithstanding that this would be arguably inconsistent with the Companies Act, this would have had far reaching and a potentially chilling effect on UK corporate governance practices, with few NEDs being prepared to expose themselves to risk, especially regarding complex and distressed corporate structures.

In review, the year has arguably seen the scope of director's potential risk reduced by Sequana, albeit qualified by (the distinguishable) Hunt v Singh, and in any event certainly not expanded in the way that the Insolvency Service sought in Carillion disqualification proceedings.

FIRE International

FIRE International: Vilamoura

3rd Annual Edition

15th - 17th May 2024

Anantara Hotel, Vilamoura, Portugal

For more details about the event, contact:

Danushka De Alwis, Founder/Director

danushka@thoughtleaders4.com

+44 2071 014191

For partnerships, contact:

Chris Leese, Founder/Director

chris@thoughtleaders4.com

+44 2071 014151

WHEN DOES A CREDITOR HAVE STANDING TO BRING A WINDING-UP APPLICATION IN THE CHANNEL ISLANDS?

Authored by: Quentin Bregg (Senior Associate) and Daisy Bovingdon (Senior Associate) - Collas Crill

The question as to whether a creditor can satisfy the legal test to enable it to apply to court for a winding-up order is a very important one for any creditor considering such an application in the hope of realising something from a company's assets in the course of a liquidation.

But which tests apply in Jersey and Guernsey? Interestingly, the answer is not the same.

The issue was recently considered by the Jersey Court of Appeal, in HWA 555 Owners LLC v Redox plc SA and Maître Nicolas Thieltgen [2023]JCA085 (HWA 555). The Court held, by majority, that it is not an absolute rule that a creditor with an unliquidated claim is unable to apply to the Court of Appeal to wind up a company.

The Jersey position

HWA 555 was the first occasion that the Jersey Court of Appeal was called upon to consider a new procedure for creditors wishing to apply to the Court to wind up a Jersey company (a Winding-Up Application), as introduced by the new Article 157A of the Companies (Jersey) Law 1991 (Article 157A).

The Court held that the ordinary and natural construction of Article 157A permits a Winding-Up Application to be made by both a creditor with a liquidated claim and by a creditor with a contingent or unliquidated claim against the debtor, as long as the claim can be demonstrated to be of a value exceeding £3,000.

The new Winding-Up Application was introduced to sit alongside the existing regime under the Bankruptcy (Désastre) Law 1990 (the Bankruptcy Law), where a creditor may apply for a declaration to place a company en désastre (a Declaration). In the Court's view, the intention of the legislature in making changes to the Companies (Jersey) Law and the Bankruptcy Law has consistently been to harmonise the structural approaches to creditors' winding-up and désastre, including on the question of standing.

Creditors with unliquidated claims could always prove in both a désastre pursuant to the Bankruptcy Law and a winding-up under the Companies Law, by making an estimate of the value of their claim. In the Court's view, there is no logical reason why a creditor with an unliquidated or contingent claim should be able to prove in a winding-up or a désastre, but not apply to the Court to have the relevant winding-up order made. In HWA 555, Matthews JA accepted that the contingency might be relevant to the equity of granting a Winding-Up Application or making a Declaration, and therefore a factor in the exercise of the Court's discretion. Further, the majority judgment does not dissent from the proposition that the Court would only in exceptional circumstances agree to make a Declaration at the instance of a creditor whose claim was the subject of genuine dispute.

However, the fact that a claim is unliquidated or contingent ought not to deprive the creditor access to the remedy as a matter of principle. There is no obvious reason why the legislature should be presumed to have intended, in Matthew JA's words, to:

“penalise the unliquidated creditor of an insolvent company who might have to sit out the debtor becoming increasingly mired in debt until a liquidated creditor decides to pull the trigger and make the application.”

There are routinely actions before the Jersey courts for general damages, where liability and quantum are disposed of separately. The courts can be trusted to reach a sound conclusion as to whether an unliquidated claim has a value over the prescribed amount; and indeed where there is a lack of legal certainty as to whether there is a debt at all. Consequently, there is no absolute rule that a creditor with an unliquidated claim cannot apply for a Declaration, or make a Winding Up Application.

The Court’s decision in HWA 555 was not, however, unanimous. Wolffe JA, dissenting, highlighted that the Jersey courts have consistently continued to restrict the category of creditors able to make the application to those with liquidated claims. In his view, an unquantified award of damages is insufficient.

Therefore, while the Court of Appeal decision in HWA 555 carries much weight, this may not be the end of the judicial conversation on the issue of standing in Jersey.

The Guernsey position

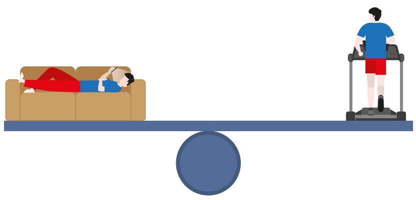
The position in Guernsey, in terms of who has standing to bring an application for the compulsory winding-up of a company, is arguably much wider.

Interestingly, there is no definition of “creditor” for the purposes of the relevant provisions of the Companies (Guernsey) Law 2008 (the Guernsey Companies Law), and guidance is taken from the 2012 decision In the Matter of Synergy Capital Limited and In the Matter of Part XXIII of The Companies (Guernsey) Law 2008 Guernsey Judgment 28/2012 (Synergy Capital). The then Deputy Bailiff found in Synergy, that in the absence of any statutory definition, “creditor” can be given its ordinary meaning as being a person to whom a debt is payable...” For the reasons explained below, this could potentially include unliquidated claims.

Under section 408 of the Guernsey Companies Law an application for the compulsory winding up of a company may be made by:

1. the company itself.
2. any director thereof.
3. a member.
4. Creditor; or
5. any other interested party.

There is, however, no definition provided in Parts XXIII and XXIV of the Guernsey Companies Law to assist in setting the requirements for a creditor’s application. Guidance is taken from Synergy Capital, where the then Deputy Bailiff confirmed that “[i]n the absence of any applicable definition in the 2008 Law, the word [“creditor”] can be given its ordinary meaning as being a person to whom a debt is payable. This potentially, although not necessarily, “encompasses future and contingent pecuniary claims”. This would, therefore, potentially include unliquidated claims which would appear to align with the recent positional change in Jersey.



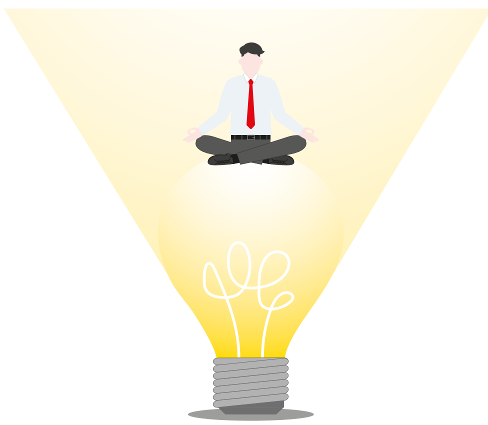
The Synergy Capital decision also provides judicial clarification of what would constitute “any other interested party”. It has been commented that the inclusion of this class of persons in provisions relating to the winding-up of companies is unique to Guernsey.

In Synergy Capital, the Deputy Bailiff provided the following guidance as to who would constitute any other interested party:

1. an interested party must be a person with an interest in the company ion question and “that interest must be treated as something broadly equivalent to, but distinct from, the interests of the persons actually specified” in section 408 of the Companies Law, i.e. the company itself, directors, member or creditors.
2. In determining whether a person would fall within the category of interested party, the Guernsey Court will have regard to all the facts and circumstances of the case and so will necessarily be fact specific on a case by case basis.
3. The basis of a person’s interest in the company will be assessed as to the degree of association or connection of that person to the company in question so as to warrant that person taking steps to bring about its dissolution.
4. Although the person in question may not be a member or creditor in the strict sense (and the Deputy Bailiff did point out that if they were, then they would fall into the other classes of persons under section 408 of the Companies Law), they might nevertheless “be the closest one can get to being a member or creditor, thereby demonstrating more interest in the company than someone… who is more remote. This will not, however, be a decisive factor”.

Conclusion

The decision in HWA 555 represents a seismic shift of the principle previously understood to apply to the question of a creditor’s standing to bring a Winding-Up Application in Jersey. Therefore, creditors may now have a more legitimate expectation that Jersey and Guernsey courts, respectively, will approach applications on a similar footing.



2023 DEVELOPMENTS

IN THE COURT'S CONTROL OF OFFICE-HOLDERS

Authored by: Alaric Watson (Barrister) - Gatehouse Chambers

This year has seen a development in insolvency law that will be welcome to every insolvency practitioner (IP): a further tightening of the already restrictive circumstances in which the court will intervene under the Insolvency Act 1986 (IA 1986) to control the decisions of office-holders.[1] Two landmark decisions were decided, both arising out of the bankruptcies of a Mr and Mrs Brake: Patley Wood Farm LLP v Kicks[2] in the Court of Appeal (Patley Wood) and Brake v Chedington Court Estate Ltd[3] in the Supreme Court (Chedington).

Any impression that the courts might be willing to consider a slightly more relaxed interpretation of these provisions[4] has been decisively rejected by these two decisions.

The court's express power to intervene to control office-holders is contained in various provisions of IA 1986, depending on the type of insolvency process.

Thus, in bankruptcy, upon the application of the bankrupt, any of the bankrupt's creditors or any other person who is dissatisfied with any act, omission or decision of the trustee, the court is empowered to review any such act, omission or decision and may confirm, reverse or modify it or give directions to the trustee or make any other order it considers fit.[5]

Equivalent provisions apply to controlling the supervisor of a voluntary arrangement, whether individual (IVA)[6] or company (CVA),[7] and the liquidator of a company in compulsory liquidation.[8] A similar provision applies in relation to administrators.[9]

1 For a discussion of the position as it was down to March 2022, see Watson & Baister Bankruptcy: Law and Practice (2023), at 9.042-9.051.

2 [2023] EWCA Civ 901.

3 [2023] UKSC 29.

4 E.g. Brake v Lowes; Brake v Swift [2020] EWCA Civ 1491, [2021] BPIR 1.

5 IA 1986, s 303(1).

6 IA 1986, s 263(3): the parallel between this provision and s 303(1) was explicitly drawn in Linfoot v Adamson [2012] BPIR 1033.

7 IA 1986, s 7(3). See Nero Holdings Ltd v Young [2021] EWHC 1453 (Ch), [2021] BPIR 1324; and Discovery (Northampton) Ltd v Debenhams Retail Ltd [2019] EWHC 2441 (Ch), [2020] BCC 9.

8 IA 1986, s 168(5).

9 IA 1986, Sch. B1, para 74. See Lehman Brothers Australia Ltd v MacNamara [2020] EWCA Civ 321, [2021] Ch 1, [2020] BPIR 550.

The wording of these provisions is intentionally broad, but the courts have consistently interpreted them narrowly, evidencing a great reluctance to interfere with the office-holder's performance of their duties so as to allow IPs to carry out their duties efficiently without having constantly to look over their shoulders.

The consensus is that something exceptional is required, bordering on perversity, before the court would be willing to interfere.[10]

Thus in Patley Wood,[11] the criticism by a creditor of the refusal by the trustees to get involved in litigation against the bankrupts regarding a property within the estate was regarded as misplaced in circumstances where there would be little gain for the estate that would remain deeply in deficit and where the indemnity of the trustees' "reasonable" costs by the creditor was inadequate. The Court of Appeal found the judge's reasoning flawed and allowed the trustees' appeal.

In particular, the courts have limited the ambit of these provisions by carefully policing the question of the applicant's standing. Although the statutory wording is seemingly wide, the courts have traditionally applied a restrictive interpretation that has been reinforced by these recent decisions.

Generally, creditors will have standing, but only where the application concerns their interests as creditors. Thus, in Re Edengate Homes (Butley Hall) Ltd,[12] the applicant complained that she had not been offered the opportunity by the liquidator to bid for an assignment of a cause of action against her: the application was rejected on the grounds that such a complaint did not relate to her interests as a creditor. The additional test, mooted in that case, for the need for the applicant's interests not to be adverse to the liquidation (or bankruptcy) and those of the creditors as a whole has now been rejected in Chedington.[13]

In bankruptcy, the bankrupt (even after discharge,[14] or in the context of an application to annul[15]) will have standing if they can show there is or is likely to be a surplus, or would be one had the impugned decision or action not been made. That is not the only way a bankrupt can show standing, but where there is no prospect of a surplus, the circumstances would have to be very special indeed.[16] A similar hurdle applies to contributories in a liquidation.

Otherwise, the residuary category of persons dissatisfied (or aggrieved)[17] is much narrower than its wording would suggest.

It is now clearer than ever that the applicant will only have standing if they can show that their rights or interests have been directly affected by an act, omission or decision of the office-holder arising out of the exercise of their statutory duties.[18]

Such instances will be rare indeed.[19]

10 Chedington [2023] UKSC 29 at [7]; Patley Wood [2023] EWCA Civ 901, at [40].. Historically, see Re a Debtor; ex parte the Debtor v Dodwell [1949] Ch 236, at 241; Re Edennote Ltd [1996] 2 BCLC 389, at 394; Osborne v Cole [1999] BPIR 251, at 255; Bramston v Haut [2012] EWCA Civ 1637, [2013] BPIR 25, at [68]-[69].

11 [2023] EWCA Civ 901, at [72]-[79].

12 [2022] EWCA Civ 626, [2022] 2 BCLC 1.

13 [2023] UKSC 29, at [97].

14 Brake v Lowes; Brake v Swift [2020] EWCA Civ 1491, [2021] BPIR 1, not criticised by the Supreme Court on this point.

15 Engel v Peri [2002] EWHC 799 (Ch), [2002] BPIR 961.

16 As in Engel v Peri (above), approved by the Supreme Court in Chedington.

17 Chedington [2023] UKSC 29 at [6] confirmed that the difference between "dissatisfied" in s 303(1) and "aggrieved" in s 168(5) is of no significance.

18 Chedington [2023] UKSC 29, at [99].

19 In Chedington, the examples of Re Hans Place Ltd [1992] BCC 737, Mohamed v Morris [2000] 2 BCLC 536 and Woodbridge v Smith [2004] BPIR 247 were cited with approval.

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CONTACT US

Roy Pollitt
Partner, New York
+1 (202) 235-6284
rpollitt@forensicrisk.com

Trevor Wiles
Partner, London
+44 (0)7711 589323
twiles@forensicrisk.com

Richard Freeman
Director, London
+44 (0)7860 837619
rfreeman@forensicrisk.com


MAITLAND

UK TOOLS UP FOR CRYPTO-RELATED CRIME

Authored by: Eoin Maclachlan (Barrister) - Maitland Chambers

Recent months have not been without their share of crypto-related news. As onlookers finished digesting the conviction of Sam Bankman-Fried on 2 November 2023 on seven counts of fraud and conspiracy relating to his former company FTX in a New York court, yet another giant of the crypto world stumbled.

On 21 November 2023, Binance Holdings Limited pleaded guilty to various charges in the United States, including violation of anti-money laundering regulations, and agreed to pay a $4 billion fine. Its CEO, Changpeng Zhao (or "CZ"), pleaded guilty to failing to maintain an effective anti-money laundering programme. He resigned as CEO and agreed to pay an individual fine of $50 million.

Over a few weeks, two of crypto's biggest names have been caught by the United States' robust approach to the crypto industry. These episodes are yet further reminders that the utopian idea that crypto could escape regulation is gone.

Against this backdrop, the Economic Crime and Corporate Transparency Act ("the ECCT") received Royal Assent on 26 October 2023. Authorities hope that it will have a significant impact on crypto-related crime in the UK.

The Economic Crime and Corporate Transparency Act 2023

The ECCT comes on foot of the Economic Crime (Transparency and Enforcement) Act 2022, which was passed in response to the Russian invasion of Ukraine, and which had sought to strengthen the UK's capacity to respond to economic crime.

The ECCT comprises a range of changes to different acts including inter alia:

1. A new "failure to prevent fraud" offence.
2. A new test for corporate criminal liability; and
3. A new set of enforcement powers for crypto assets.

Crypto-related enforcement powers in the ECCT

The prevailing asset recovery legislation is the Proceeds of Crime Act 2002 ("POCA"). It was widely felt that this regime had not kept pace with the development of cryptoassets and related technologies.

POCA can be understood as containing two categories of asset recovery powers, those within a criminal regime (Parts 2, 3 and 4 of POCA) and those within a civil regime (Part 5 of POCA).

1. Criminal powers: these are in personam powers aimed at imposing a debt against those persons who have either been convicted of a crime or benefited from their crime.
2. Civil powers: these are in rem powers which are used to obtain possession of assets which have been acquired through unlawful actions or which are intended to be used for unlawful conduct.

The ECCT aims to significantly strengthen both categories of asset recovery power, while also amending counter-terrorism legislation to ensure enforcement authorities are able to tackle the use of cryptoassets in that context.

Criminal reforms

Schedule 8 to the ECCT amends POCA to make provision in relation to cryptoassets and confiscation orders under Parts 2, 3 and 4 of POCA.

The most critical changes are as follows:

1. Provides that officers may recover cryptoassets in a manner similar to tangible property. Existing search, seize and detention powers are to be adjusted to ensure that officers can “recreate” crypto wallets and transfer assets to a wallet controlled by the relevant law enforcement agency.
2. Enables magistrates’ court to authorise the sale of cryptoassets. This broadens their current power to do so in relation to cash, funds in bank accounts and other seized assets.
3. Provides for the destruction of cryptoassets in narrow circumstances.
4. Removes the requirement that a person be arrested prior to the use of seizure powers in some cases. Though of wider application, this change will be critical in relation to cryptoassets, where it would rarely be possible to identify and then arrest an individual.

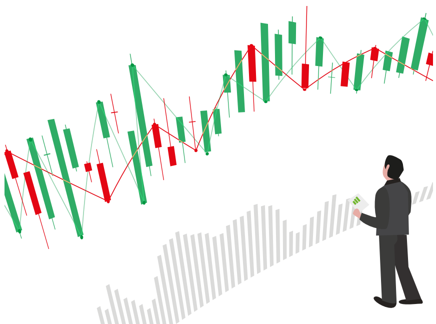
Civil reforms

Schedule 9 of the ECCT amends POCA to make provision for civil recovery in relation to cryptoassets.

The most critical change is to create new forfeiture powers so that the relevant authorities may recover cryptoassets in the magistrates’ court. The following are significant changes:

1. Enables law enforcement to recover cryptoassets held by crypto exchanges and custodian wallet providers.
2. Provides for cryptoassets, whether detained or frozen, to be converted to cash. This will allow for the value of the assets to be protected, given their tendency to fluctuate significantly in value.
3. Provides for the destruction of cryptoassets in narrow circumstances.

The ECCT also empowers the Secretary of State to amend certain definitions in the Act (including “cryptoasset,” “crypto wallet” and “cryptoasset service provider”) by regulation to ensure both the criminal and civil regime can adapt to the rapidly changing technological environment.



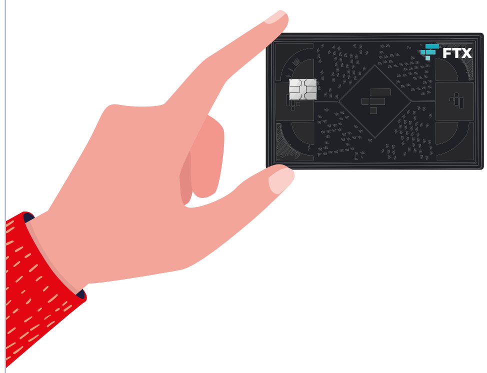
Counterterrorism

Finally, the ECCT will provide law enforcement with the necessary powers to seize, freeze and forfeit crypto assets which could either could be used or have been used for the purpose of terrorism.

Conclusion

The ECCT fits within an increasingly complicated web of crypto-related rules in the UK. The present government has made establishing the UK as a global hub for crypto assets a priority, but this Act makes clear that the government is also aware of the critical importance of regulating the industry’s sharp edges. For many, the industry is synonymous with fraud. Many consumers have been the victim of crypto-related scams. The maturing of the industry will require governments to protect consumers and limit the use of crypto assets in the context of criminality.

The ECCT is a step in that direction by the UK.

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DIRECTOR'S DISQUALIFICATION FOR COVID-19 FRAUD

Authored by: Alice Court (Solicitor) - Irwin Mitchell and Jessica Powers (Barrister) - New Square Chambers

The COVID-19 pandemic is something that the majority of us want to forget. However, three years on its repercussions for families, businesses and the economy continue to be felt.

In particular, concerns about the level of abuse of the financial support schemes implemented during the pandemic continue to make the headlines.

In the last few months, HMRC put a final estimate on the amounts lost to error and fraud. That figure is a shocking £5bn.

The last two years have seen a steady ramping up of disqualification proceedings against directors accused of dishonestly applying for, and misappropriating financial support.

As of April 2023, more than 450 directors have been disqualified for abuse of the financial support schemes, with the average period of disqualification exceeding seven years.

The disqualification of directors who wrongly caused companies to apply for Bounce Back Loans ("BBL") appears to be the latest trend.

Disqualification

In Secretary of State for Business, Energy and Industrial Strategy v Deea Construct Ltd [2023] EWHC 2084 (Ch) the director, Marian Ghimpu, was accused of providing false or inaccurate information when applying for a BBL, which enabled Deea Construct Ltd to secure a larger loan than it was entitled to, and then using the monies for his own benefit. When the loan was due to be repaid, Mr Ghimpu put the company into CVL.

Chief ICC Judge Briggs had no hesitation in finding that Mr Ghimpu's conduct fell below the expected standards of probity and competence. He noted that Mr Ghimpu had either been incompetent, or deceitful, and that his false representation was particularly heinous because it was made at a time when the Government had placed trust and confidence in directors to honestly represent the financial status of companies when seeking financial support for their maintenance and survival. The Judge was assisted by comments made in R v Dagistan [2023] EWCA Crim 636 to the effect that exploitation of the BBL scheme (described as an "exceptionally vulnerable target at a time of national emergency") increased the level of a director's culpability.

The period of disqualification imposed was lengthy: 13 years. The Judge observed that Mr Ghimpu's breaches of commercial probity were particularly serious, and that a long period ought to be imposed if the disqualification regime is to have any teeth.

Compensation orders

Mr Ghimpu was also the unfortunate recipient of a sizeable compensation order.

The Court can make a compensation order where a person is disqualified by Court order, and the conduct for which they were disqualified has caused loss to a creditor of an insolvent company of which they have at any time been a director. As noted by ICC Judge Prentis in Re Noble Vintners Ltd [2019] EWHC 2806 (Ch), the intention behind the compensation order regime is to "[…] enhance in the public interest the protective aspect of the disqualification regime by giving monetary redress to creditors financially affected by the misconduct, thereby giving the regime as a whole more 'bite' […]".

The Court's power to make compensation orders was introduced in 2015. However, that power has been rarely employed: the Secretary of State has only made two applications, with the first in 2019, and the order against Mr Ghimpu was the first obtained by the Insolvency Service.

The potential difficulties facing office-holders in bringing misfeasance proceedings for abuse of the COVID-19 financial support schemes, particularly where the director did not personally benefit, coupled with the political pressure to recoup the billions lost, mean that compensation orders could become much more common.

Advising directors

It is important for directors facing allegations of financial abuse to obtain legal advice at the earliest opportunity for a host of reasons. In particular, any responses submitted during a disqualification investigation are often used against directors to form the basis of the allegations of unfitness, and it may be in the director's interest to head off proceedings early by agreeing a disqualification undertaking.

A disqualification undertaking is essentially an agreement reached between the director and the Secretary of State that the individual will not be a director, or concerned in the promotion, formation or management of a company for an agreed period.

Agreeing a disqualification undertaking avoids the significant time and costs involved with proceedings, and provides certainty. Historically, it was often possible to agree reduced periods of disqualification, especially if mitigating factors were advanced. Relevant mitigating factors might include reliance upon independent professional advice, being a first-time offender, the absence of any allegations of fraud or dishonesty, and the director not having received a personal benefit as a result of their misconduct. However, the Insolvency Service is currently reluctant to agree to significantly reduced periods of disqualification, and, in practice, it is rare to obtain a reduction of more than one year. Of course, even a minimal reduction could bring the period down from the top, most serious band, to the middle band of disqualification periods, which may assist in making an application for permission to act.

Applications for permission to act

Directors faced with incontrovertible allegations of misconduct, or who have no appetite for fighting a disqualification case to trial often elect to agree a disqualification undertaking and then apply for the Court's permission to act as a director of other companies.

A disqualification undertaking ordinarily comes into effect 21 days after signature. It is therefore important that any permission to act application is prepared well in advance and issued in good time. It may also be necessary to seek interim relief, pending final determination.

The Court will take into account a number of factors when exercising its discretion to award permission to act.

Most notably, an application must demonstrate that it is important that the applicant (as opposed to anyone else) be a director, and that sufficient controls are in place to prevent the misconduct in question from re-occurring, so as to protect the public.

Naturally, directors with higher periods of disqualification, and those who are found to have acted dishonestly or fraudulently will find it more difficult to persuade the Court to grant leave. The Court is likely to have concerns about granting permission to act where a director has been disqualified because of abuse of COVID-19 financial support schemes, even if they have not directly been accused of fraud or dishonesty.

If the Court does grant permission to act in a financial support scheme abuse case, that permission is likely to come with the imposition of stringent conditions. For example, the director might be prohibited from entering into loan agreements on behalf of the company, or might be prohibited from paying money to themselves unless all other creditors are paid. It is always helpful to try and negotiate the conditions with the Insolvency Service in advance.

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PARTNER

Founding Committee Member,
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Mob: +44 (0)7769 316 592
Email: jon.felce@cyklaw.com

CV here

Natalie Todd
PARTNER

Founding Committee Member,
Disputes nextgen community

Mob: +44 (0)7879 018 014
Email: natalie.todd@cyklaw.com

CV here

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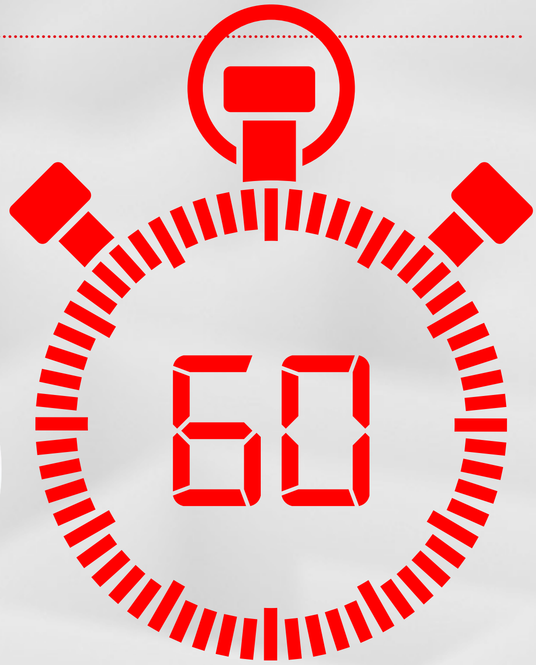


AMY HARVEY
PARTNER
ONTIER

Q What do you see as the most important thing about your job?

A Helping navigate clients through what is often the most stressful phase of their personal or professional lives to reach a resolution that whilst they may not always be happy with, allows them to get on with their livelihoods.

Q As a member of the Advisory Board for Women in FIRE. Why are these initiatives in your view important for the industry?

A We have come a long way since I started out in terms of voices and representation, particularly at the senior level, but there is still a long way to go. Initiatives which actively promote female engagement and representation can only help encourage diversity of experience and thought which is not only important for the industry but also our ultimate clients.

Q As we approach the end of 2023, what has been the most interesting case or development you have seen this year?

A In the crypto space we've seen continual development of the remedies available to assist victims of fraud, often through judicial innovation. In particular, we've seen service via NFT, interesting orders for delivery up and further novel interlocutory orders. It's an exciting time to be a litigator in this field.

Q What do you see as the most significant trend in your practice in a year's time?

A With the economy under continuing stress and businesses and individuals under increasing financial pressure I see an uptick in both insolvency and fraud matters – the main corners of the fraud triangle are well and truly engaged.

Q What has been your greatest work-related achievement in 2023?

A Two highlights – firstly, being nominated for Crypto Powerwoman of the Year and secondly, navigating my first heavy litigation under PD 57AD!

Q What has been the best piece of advice you have been given in your career?

A If you don't know the answer and/or don't know where to find the answer – admit it. It's ok to always be learning.

Q What is one important skill that you think everyone should have?

A Properly listening - not just waiting for the other person to finish speaking. Knowing how to use adobe pagination is also very handy.

Q What cause are you passionate about?

A Proper support and mentoring for those continuing their practice and wanting to further progress their career after either maternity leave or a career break. Those returners have often gained and improved multiple skills over that period and that should be acknowledged and celebrated rather than any focus on them having been "out of the loop".

Q Where has been your favourite holiday destination and why?

A India - the food, the people and the history. I've been to the North and I'm hoping to be able to return again to explore other regions in the not-too-distant future (although with 2 children now in tow it might be a different experience!)

Q If you could bring back a fashion trend, what would it be and why?

A It feels like most of the fashion trends I followed in the 90s are already back (for better or for worse) but ponchos don't seem to have made the cut – whilst ugly I think they'd be good for keeping warm whilst working from home.

Q Reflecting on 2023, what three words would you use to sum up the year?

A Challenging, rewarding, fun (mostly).

Q What is one goal you have for 2024?

A Less phone, more books.

DIFC COURT HOLDS PROVISIONAL AWARD ON INTERIM MEASURES TO BE ENFORCEABLE

Authored by: Sumru Akter (Investment Manager) - Omni Bridgeway

The Court of the Dubai International Financial Centre (DIFC) gave an important decision on 19 September 2023 concerning the enforceability of interim measures rendered by arbitral tribunals. The DIFC Court decided that regardless of the seat, awards on interim measures rendered by tribunals were enforceable by the DIFC Court. The decision is significant for clarifying the enforceability of provisional awards in the DIFC and confirms the progressive stance of the DIFC Court in support of effective dispute resolution.

In the decision Muhallam v Muhaf (ARB 021/2022), the issue before the DIFC Court was whether it had jurisdiction to enforce a provisional award on interim measures rendered by an arbitral tribunal seated outside the DIFC.

The Defendant challenged the DIFC Court's ex parte order, which had provided for the enforcement of the tribunal's award on interim measures, on the basis that interim measures were not enforceable as they did not constitute an "arbitral award" for the purposes of Articles 42 and 43 of the DIFC Arbitration Law. The Defendant further argued that the mechanism under Article 24(2) was the only way to enforce interim measures in the DIFC.

The DIFC Arbitration Law gives power to tribunals seated within the DIFC and the DIFC Court to order interim measures (Articles 24(1) and 24(3)). The recognition and enforcement of arbitral awards in the DIFC are governed by Articles 42 and 43 of the DIFC Arbitration Law which do not expressly govern the recognition and enforcement of interim measures granted by tribunals. The only express provision in the DIFC Arbitration Law on the issue is Article 24(2) which governs the enforcement of interim measures rendered by tribunals seated in the DIFC. The arguments in this case concerned the enforceability of interim measures rendered by tribunals seated outside the DIFC.

With reference to international court practices and scholarly views, the DIFC Court analyzed the issue under Articles 42 and 43 of the DIFC Arbitration Law. The Court stated that neither the New York Convention, nor the UNCITRAL Model Law (which forms the basis of the DIFC Arbitration Law), prevented the Court from deciding that interim measures are "awards" for the purposes of enforcement. The Court stated that the DIFC Arbitration Law itself recognizes that interim measures for the purposes of enforcement under Article 24 can be "in the form of an award or in another form".

The Court concluded that, as long as an interim measure qualified as an award, it could be recognized and enforced under Articles 42 and 43 of the DIFC Arbitration Law.

The Court also dismissed the Defendant's argument that Article 24(2) was the "source of an exclusive jurisdiction" to enforce interim measures granted by tribunals. The Court held that Article 24(2) mainly provided for a "more summary procedure" for the enforcement of interim measures, rendered by DIFC-seated tribunals, which allows enforcement with the written permission of the tribunal.

Comment

The speed and effectiveness of the implementation of interim measures, such as freezing orders or injunctions, can play a crucial role in protecting litigants and ensuring a meaningful adjudication on the merits. The Muhallam v Muhaf decision is a key development for clarifying that provisional awards on interim measures are enforceable in the DIFC.

The developments in the case law of the DIFC Courts continue to strengthen its reputation as an arbitration-friendly venue and a reliable jurisdiction for effective resolution of disputes. Further tools available to litigants under DIFC law, such as adverse costs[1] or contempt of court[2] orders against parties failing to comply with court decisions, as well as the reciprocal enforcement protocol between the DIFC Courts and the 'onshore' Courts of Dubai[3], make the DIFC an attractive venue for litigants who seek to resolve their disputes swiftly and efficiently.

1 Part 38 of the Rules of DIFC Courts.
2 Part 52 of the Rules of DIFC Courts.
3 The Law of the Judicial Authority at Dubai International Financial Centre, Law No.12 of 2004.

CAYMAN RESTRUCTURING UPDATE DECISION OF THE GRAND COURT ON 4TH OCTOBER

Authored by: Nour Khaleq (Senior Associate) - Ogier

The Grand Court of the Cayman Islands has recently dismissed a petition for the appointment of restructuring officers pursuant to the restructuring regime introduced in the Cayman Islands in August 2022. The case provides helpful clarification of the nature of evidence that is required to be put before the Court to engage its jurisdiction to appoint restructuring officers and will allow companies to be better prepared when seeking to utilise the Cayman Islands restructuring regime with the benefit of the automatic moratorium.

On 23 August 2023, Aubit International (the Company) presented a petition (the Petition) seeking the appointment of qualified insolvency practitioners as restructuring officers of the Company (ROs) pursuant to section 91B of the Companies Act (2023 Revision) (the Act).

The Petition was presented on the basis that the Company (a) was unable to pay its debts; and (b) intended to present a compromise or arrangement to its creditors[1]. As to each limb of the section 91B test, the Company submitted:

- It was unable to pay its debts due to, among other reasons, its inability to access US$60.4million in fiat currencies and cryptocurrencies held in the Company's brokerage accounts in Greece; and
- A restructuring would take place in two phases; first, an asset and information gathering phase in order to enable the Company to formulate the terms of a recovery or restructuring plan, followed by a more typical restructuring phase once the exact financial position of the Company and its potential asset recoveries had been ascertained. The Company's evidence suggested that the Company intended to present a consensual restructuring plan once all available assets had been recovered by the ROs.

The appointment of ROs was supported by creditors of the Company.

The legal test

In his judgment, Doyle J reviewed the first decision of the Court considering the restructuring regime in Re Oriente Group Limited[2] and earlier judgments relating to the appointment of soft-touch provisional liquidators under the amended section 104(3) of the Act (which the Court described as relevant and persuasive). Following an extensive review of those authorities, Doyle J listed 25 non-exhaustive factors to which the Court may have regard when considering an application for the appointment of ROs: the first of which was to emphasise that the Court's jurisdiction to appoint ROs is only engaged when both the statutory limbs set out in section 91B of the Act are satisfied (and that the burden is on a company to prove the satisfaction of those limbs on a balance of probabilities); and the last of which was to acknowledge that every case must be dealt with on its own facts and circumstances.

Some of the key factors listed by the Court include:

- The Court may use its flexible discretionary power to enable the rescue of a company where it is just to do so, but should ensure that the jurisdiction is not abused by a company which is hopelessly insolvent and continues to trade.
- The Court must consider whether (i) the restructuring is likely to be more beneficial to creditors than a winding up (ii) there is a real prospect of a restructuring being effected for the benefit of the general body of creditors; and (iii) in all the circumstances it is in the best interests of the creditors to try and achieve a restructuring.
- Creditors' views are relevant and important. The Court would normally expect to see evidence of some form of engagement with creditors prior to a petition being presented, with a view to developing the terms of a proposed restructuring.

1 Cayman Islands welcomes introduction of reforms to restructuring regime | Ogier
2 A new beginning for restructuring in the Cayman Islands | Ogier

- The intention to present a restructuring plan must be a realistic, genuine, bona fide held intention on adequate grounds. The Court does not have to be provided with “the finished, fully-grown plant but the seeds must be sufficient to suggest that it is likely the plant will bear some fruit before too long”.
- In some cases the bare genuine bones of a restructuring plan may suffice or at least be persuasive enough to permit the appointment of ROs to report on the viability of a plan, but in some cases in the absence of: (a) meaningful consultation with outside creditors and their support and (b) independent confirmation from third-party professionals of the viability of the potential plan and the benefits of restructuring as opposed to a winding up, the Court may conclude that there is no genuine intention to move forward with a credible plan that has a reasonable chance of success.
- The Court will need to be satisfied that management genuinely require and deserve “breathing space” to finalise a restructuring plan with creditors which has a reasonable chance of success, and that it would be in the best interests of creditors to enable the company to continue as a going concern.
- Even if the company and all creditors agree to the appointment of ROs, the Court must nevertheless be satisfied that it has jurisdiction to make an order and that making an order would, in its discretion, be a proper exercise of such jurisdiction.
- The petition should contain the information required by the Act, the Companies Winding Up Rules and case law and should clearly specify the grounds of the application.

Decision

Doyle J observed that, while there was inadequate evidence as to the financial position of the Company, its concession that it was unable to pay its debts within the meaning of section 93 of the Act meant the first limb of the statutory test was satisfied.

The Company however failed to satisfy the second limb of the statutory test because there was “extremely limited information concerning the proposed “restructuring plan””. While the Court accepted that it was not essential to demonstrate that there was a present restructuring plan or one that was to be implemented in the near future, it was still incumbent on the Court to scrutinise whether there was, on the evidence before it, a genuine and realistic intention to present a credible restructuring plan. Having regard to the evidence before him, Doyle J observed that:

- The Company’s evidence was devoid of any meaningful detail such that “it was difficult to come to the conclusion that there was a genuine intention to present, at least in the near future, a meaningful restructuring plan which would have reasonable prospects of success”.
- The two-phase approach referred to above was not a proper use of the restructuring officer regime. On the contrary, it was found to be premature as the Company should have taken steps to recover its assets and documents to ascertain its financial position prior to filing the Petition. His Lordship commented that it appeared that the first phase proposed by the Company was for the purpose of allowing it to then satisfy the Court on the second limb of the test for the appointment of ROs.
- It was improper to use the restructuring regime for the purpose of assisting in forensic investigations, commencing legal proceedings and obtaining assets, documents and information.
- It was also improper to use the statutory moratorium for the purpose of adding credibility and respectability to a company’s own management.

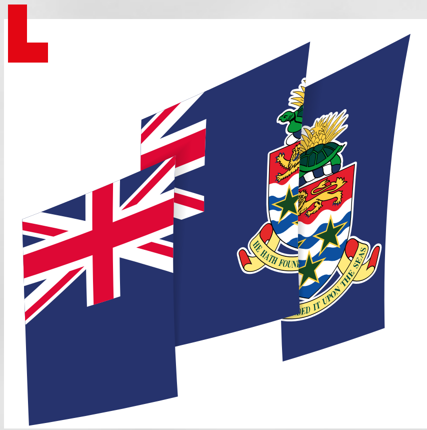
The decision highlights that the Court’s jurisdiction to appoint restructuring officers is only engaged when the two statutory grounds set out in section 91B have been satisfied, and it is only then that the Court may consider whether in its discretion it is just, fair and appropriate to appoint ROs and, if so, what functions and powers to give them.

In reaching his decision, Doyle J emphasised the need to guard against potential abuse of the restructuring regime, in particular to ensure the enhancement of international cross-jurisdictional cooperation while simultaneously ensuring that relevant competing interests are duly balanced. Such protection was particularly acute in the context of the worldwide automatic statutory moratorium under section 91G of the Act which is imposed upon the presentation of a petition, and which the Court noted cannot be allowed to run indefinitely.

Notwithstanding that the Petition was dismissed, companies wishing to restructure with the benefit of a statutory moratorium should not be deterred from the use of the restructuring regime. The circumstances of this case were certainly unusual in that the Company presenting the restructuring plan was not fully aware of its own financial position at the time of presenting the Petition.

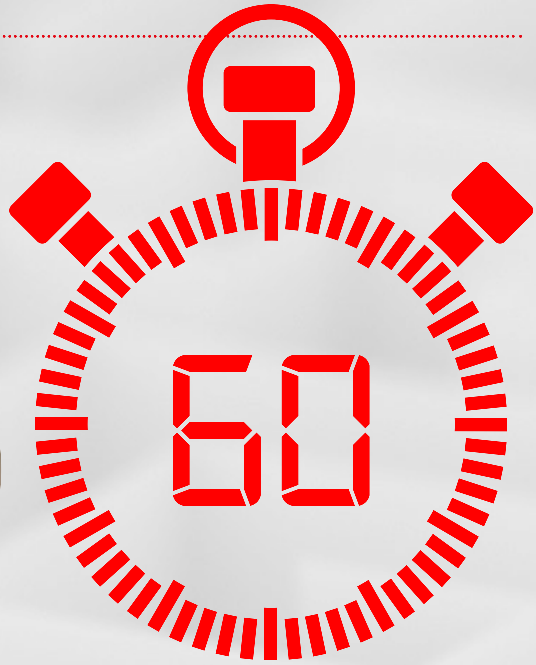
In our view the decision is positive for the jurisdiction as it clarifies for future applicants the evidence required to be filed in support of a petition under the regime and emphasises the commitment of the Cayman Court to work towards international cooperation for the benefit of companies as well as the protection of creditors.

The lessons learnt from the judgment in Aubit International, together with the guidance provided by the Court following the appointment of ROs in Re Oriente Group Limited, the successful restructuring of Rockley Photonics Holdings Limited and the withdrawal of the RO petition relating to Differ Group Auto Limited provide practitioners, companies and creditors looking to use the RO regime with useful guidance as we see an uptick in restructuring inquiries and activities across the market.



60-SECONDS WITH:

JESSICA BROOKE
BARRISTER
WILBERFORCE CHAMBERS



Q **What do you see as the most important thing about your job?**

A Making sure that you are on top of everything, both facts and law; it's difficult to formulate effective tactics unless you really understand a case inside out. Running a case is also much more enjoyable when you have limited the unknowns that could potentially derail your position.

Q **As a member of the Advisory Board for Women in FIRE why are these initiatives in your view important for the industry?**

A Fraud and insolvency work remains pretty male-dominated, and quite often women can feel disconnected. Women in FIRE initiatives are a reminder that this is an industry full of brilliant and talented women, and a place in which women can and do thrive. For me, connecting with interesting women working in the same area has not only been very inspiring, but great fun; it's simply much more enjoyable to work in an environment which includes people you know and admire.

Q **As we approach the end of 2023, what has been the most interesting case or development you have seen this year?**

A I was involved in a case earlier this year representing a client whose co-director had caused the company to sell luxury goods into Russia in breach of UK sanctions legislation. We obtained a passport order against the respondent and an array of injunctive relief, stripping him of his directorship and preventing him from contacting customers or employees, or approaching the company's premises, and requiring him to hand over his mobile phone and laptop to be imaged. The respondent was out of the jurisdiction at the time of the application, and we arranged for a process server to serve him when he flew into Heathrow; he attempted to avoid service and took the process server on a car chase through London. It was a fascinating case to be part of.

Q **What do you see as the most significant trend in your practice in a year's time?**

A I'm sure there will be an increase in contentious insolvency work this year - this forms a significant part of my practice alongside commercial, fraud and international work. The industry has been expecting a substantial up-tick in insolvency disputes since the pandemic, and although that has not quite happened yet, I've definitely felt things heating up this year.

Q **What has been your greatest work-related achievement in 2023?**

A Getting a great result for my clients in a hard-fought 7-day trial in the High Court involving a shareholder dispute. I particularly enjoyed cross-examining over several days, and the adrenaline kick when its going well really makes this job worthwhile. And winning a case is always a great feeling.

Q **What has been the best piece of advice you have been given in your career?**

A Every case is the most important case to your client. I try to make sure that every time I step into court I remember that everything I do really matters to those I am representing, whatever their circumstances.

Q **What is one important skill that you think everyone should have?**

A Having a sense of humour. Working in this industry is intense and interactions between opposing teams can be really aggressive; it is easy to get bogged-down in these negative interactions. Having light-hearted moments whilst working in a team – and with your opponents too - reminds you of the real focus of the case.

Q **What cause are you passionate about?**

A Social mobility at the bar. I went to a state school and it is really dispiriting to think that people from different backgrounds might be put off from applying to the bar because they are intimidated or feel that they won't fit in. The bar is, in fact, welcoming and there is a much wider spectrum of people than first appears, so it is important to spread that message - although there is still a lot of work to do.

Q **Where has been your favourite holiday destination and why?**

A New Zealand, which is an adventure playground for grown-ups; highlights include skydiving, hiking ice glaciers, caving, and whale watching.

Q **If you could bring back a fashion trend, what would it be and why?**

A All the terrible clothes of the noughties (think Marissa and Summer in The OC), although it looks like Gen Z have already caught on.

Q **Reflecting on 2023, what three words would you use to sum up the year?**

A Fast-paced, exciting, intense.

Q **What is one goal you have for 2024?**

A To work as hard as I can and to keep improving, so as to keep advancing in my career – and allowing me to continue being a part of the sort of fast-paced and interesting work that I've been fortunate enough to see in recent years. This job is hard work, but working on exciting, intellectually challenging cases with a great team makes things feel easy.

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For further information and to get in touch, contact:

Alan Sheeley
Partner, Head of Civil Fraud
alan.sheeley@pinsentmasons.com
+44 (0)20 7054 2626

Seema Bono
Partner
seema.bono@pinsentmasons.com
+971 4 373 9759

Andrew Barns-Graham
Legal Director
andrew.barns-graham@pinsentmasons.com
+44 (0)20 7490 9309

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REGULATING THE LEGAL GREY AREA OF CRYPTO ASSETS

Authored by: Sarah Twohig (Senior Associate) - Pinsent Masons (Ireland)

Cryptocurrencies and assets are moving firmly towards legitimisation. However, as technology innovation outpaces the implementation of regulation of crypto assets, this presents challenges for regulators and businesses alike.

Much of what is attractive to investors and businesses about crypto assets and blockchain technology, such as anonymity and cross-border reach, pose challenges from a regulatory perspective. Regulators must reconcile legal certainty with crypto assets' libertarian roots.

On the one hand, regulators need to present clear, legal definitions regarding crypto assets that are flexible enough to allow innovation. On the other hand, regulations must provide firm legal safeguards for consumers and address perceived threats to monetary sovereignty and financial stability. This presents a delicate balance for regulators between innovation, legal risk and investor protection.

In recent years, we have seen regulatory responses from some global economies, such as China, that have placed an all-out ban on cryptocurrencies rather than regulating them. The European Union's ("EU") regulatory approach to crypto assets starkly differs to this.

The EU's harmonised approach to crypto regulation and supervision

In April 2023, the European Parliament held its final vote on the adoption of regulation on markets in crypto assets ("MiCA"), which was published in the Official Journal of the European Union on 9 June 2023.

From December 2024, MiCA will apply to all EU member states and will introduce a dedicated and harmonised regulatory framework for crypto assets service providers ("CASPs") in the EU.

MiCA will bring issuers of certain types of crypto assets into the EU regulatory framework and will establish new rules for stablecoins, including asset-referenced tokens, e-money tokens and utility tokens.

From a legal perspective, the introduction of MiCA will provide clarity on the regulatory status of crypto assets and protection for crypto asset holders in the EU because it will establish a set of common rules around the supervision of crypto assets and cryptocurrencies for the first time. It will also provide a blueprint for other regulators worldwide in terms of bridging gaps between regulation, investor protection and innovation.

Risk of "forum shopping"

On 17 October 2023, the European Securities and Market Authority ("ESMA") called on CASPs and national competent authorities ("NCAs") of EU member states, who are responsible for the implementation of MiCA in home member states, to ensure the smooth and coordinated transition of MiCA by December 2024.

ESMA has highlighted "forum shopping" as a potential risk if EU member states do not adopt a consistent approach when implementing MiCA. This could lead to divergences in the enforcement of MiCA in the EU thereby reducing the overall effectiveness of the regulatory framework. To avoid the risk of "forum shopping", ESMA has called on the NCAs of EU member states to ensure that they have adequate powers and resources to exercise their supervisory and enforcement responsibilities under MiCA.

A robust EU regulatory framework of harmonised rules for issuers of crypto assets and CASPs is necessary in the wake of crypto frauds and insolvencies such as FTX, Terraform Labs and Three Arrows Capital. These crypto frauds highlighted corporate governance failings and failure to retain or ringfence client assets in the absence of regulation.

MiCA will help close legal loopholes that have developed without clear regulation and will go some way towards ensuring regulatory compliance and limiting crypto fraud in a largely unregulated space.

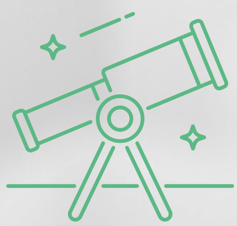
However, it will be necessary for ESMA and NCAs, such as the Central Bank of Ireland, to provide definitive clarification in due course on the extent of how existing regulatory regimes, such as Markets in Financial Instruments Directive ("MiFID"), apply to crypto assets.

Regulatory challenges for crypto businesses

2023 has been a defining year for regulatory investigations and disputes involving crypto assets, with record levels of investigations by US enforcement agencies against crypto exchanges and notable judgments handed down in crypto court cases. The courts have been pragmatic in adapting existing legal remedies to help protect rights in cases of crypto fraud in the absence of clear regulation or legislation. However, crypto businesses should now prioritise operational screening, such as anti-money laundering and know-your-client checks, to satisfy themselves that assets in their custody are not the proceeds of crypto fraud and to ensure operating resilience to financial crime. There is also a growing importance on enhanced due diligence investigations and cryptocurrency compliance at the outset for crypto businesses, who should satisfy themselves that they have adequately traced and identified the source of crypto funds so that any bad actors who have gained funds from illicit activities can be identified. Businesses should ensure that compliance is not simply a box-ticking exercise and key challenge for them will be to scale up their compliance functions with their growing business.

ESMA's recent statement helps clarify the supervisory expectations of both NCAs and CASPs operating in the EU. It expects NCAs to establish supervisory procedures relating to the authorisation processes set out under MiCA. It also expects CASPs to apply for MiCA authorisation as otherwise they cannot benefit from passporting rights under MiCA in the MiCA transition period, which runs up until December 2024.

To prepare, CASPs currently operating in the EU should ensure that business practices comply with incoming MiCA requirements to mitigate against disruption to business models. They should also now engage with NCAs to determine how the new regulatory framework will affect their current business activities. Lastly, for CASPs operating in more than one EU member state, ESMA reminds them that local law will apply until the end of the transitional period in December 2024.



The future of crypto regulation

Throughout 2023, US regulators have invested heavily in their regulatory resources to tackle crypto fraud, so regulatory enforcement and disputes concerning crypto assets will be a major theme in the coming years. We are entering an era of heightened regulatory supervision for crypto assets and the regulatory landscape will be dominated by enforcement at a global level with some regulators taking transnational steps to enforce crypto regulations.

Notable crypto judgments handed down in 2023 suggest the possibility of blockchain developers owing legal and fiduciary duties to cryptocurrency owners in cases of crypto fraud. Such judgments show that the old rules still apply and there is no substitute for effective due diligence.

60-SECONDS WITH:

LAURA WEBSTER
BARRISTER
NEW SQUARE CHAMBERS

Q What do you see as the most important thing about your job?

A Delivering the best result for my clients with the cards that I have been given – I cannot work miracles(!) but I can work to ensure that the best result that can be achieved is achieved.

Q As we approach the end of 2023, what has been the most interesting case or development you have seen this year?

A The decision of the Supreme Court in Philipp v Barclays Bank UK PLC [2023] UKSC 25 which concerned "authorised push payment" (APP) fraud and the Quincecare duty was particularly interesting. I wasn't involved in the case, but I have already made reference to it.

Q What do you see as the most significant trend in your practice in a year's time?

A A large proportion of my work involves insolvency and property, unfortunately as a result of high interest rates I foresee increased work in this area as a result of borrowers defaulting on loan agreements. In the long term I predict an increase in frauds utilising "deepfake".

Q What has been your greatest work-related achievement in 2023?

A I did my first mediation as a mediator, and it was a success!

Q What has been the best piece of advice you have been given in your career?

A Never assume anything (even if it appears obvious) - check everything for absolute certainty.

Q What is one important skill that you think everyone should have?

A Literacy, shockingly 1 in 6 adults in England can be described as functionally illiterate.

Q What cause are you passionate about?

A Ending stigma and discrimination in mental health.

Q Where has been your favourite holiday destination and why?

A The Maldives, because of the beaches and reefs.

Q If you could bring back a fashion trend, what would it be and why?

A The hippie fashion trend from the '60s complete with headbands! I love the colorful and relaxed clothing, and the wide range of beautiful patterns.

Q Reflecting on 2023, what three words would you use to sum up the year?

A A Busy One.

Q What is one goal you have for 2024?

A While my chambers is located in London, I have recently moved back to Norfolk and I would love to build relationships with the solicitors of firms in this county.

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CROSSING THE LINE

Authored by: Elizabeth Ross (Associate Managing Director) - Kroll

When optimism becomes fraud

Following a boom year in 2021 where venture capital funding surged, global economic tailwinds and a notably higher interest rate environment have resulted in a marked downturn in deal-making activity. High-profile corporate failures, underpinned by allegations of fraud and misrepresentation, have also weighed on investor appetite for some early-stage ventures.

In April 2023, Charlie Javice, the founder of Frank, a U.S.-based startup focused on assisting students and their families applying for college financial aid, was arrested following accusations JP Morgan Chase was deliberately misled over customer data during the pre-investment due diligence process. In the same month Elizabeth Holmes, founder of Theranos, began an 11-year prison sentence. The trial of Sam Bankman-Fried concluded with his conviction in November 2023 for fraud following the collapse of FTX.

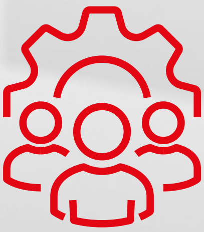
These are just a selection of cases that have made the headlines, where once highly-regarded entrepreneurs have had a spectacular downfall, along with their businesses. But there are thousands of other, less well-known examples of startups that have attracted investment because they showed such promise yet have turned out not to be the investments they seemed. In this article, we look at the ways in which startups can become hospitable environments for fraud, as a result of the conflation of a number of common attributes conducive to malpractice, namely weak corporate governance, counterproductive employee incentivisation plans, and growth or KPI targets which can encourage management to rationalise poor decision-making.

Corporate culture under scrutiny

Energy, optimism and innovation are all hallmarks of startups, and experienced investors know that most of these companies may never meet the growth projections in the timeline anticipated by their founders—many will even fail. Following the financial crash of 2008 and the resulting historically low interest rate environment, valuations nevertheless grew exponentially.

However, the rationale for the aggressive growth estimates underpinning these valuations is increasingly under scrutiny, not just for potential financial risk, but legal and reputational issues, should the company ultimately prove unable to defend its claims. It's one thing to be highly optimistic about the outlook for a new product. It's another matter to make representations that far exceed the company's capacity to deliver.

Investors have a vital role to play in governance by engaging in thorough due diligence of a target company and the management team prior to acquisition, followed by careful ongoing monitoring throughout the lifecycle of their investment. Not doing so carries the reputational risk of misrepresentation in company financials and shows a reluctance or an inability to test credibility of a business case. A lack of scrutiny could even lead to allegations of collusion, should misrepresentation later be uncovered.



Role of the founder and senior management team

The starting point for good governance is the founder and senior management team, who must set the tone for transparency.

A founder will naturally be protective of intellectual property (IP), but investors must consider carefully whether a management team is closely guarding certain key data out of concern for a genuine commercial threat, or because all or part of the fundamentals that the team is relying on for product specification or revenue growth are not in place—and not even close.

Steve Jobs may have famously said: "The people who are crazy enough to think they can change the world are the ones who do." But buying into an entrepreneur's vision should not preclude hard questions around the status of key elements of the technology or business plan, and a strong management team will engage in discussions around their best, average and worst-case growth scenarios. Is the company already working with or open to the idea of having a third-party valuation advisor cross-check its assumptions? How might the company's estimates compare to industry norms? Is the company relying on the "novelty" of the business concept to justify a lack of disclosure? If the company operates in an emerging or frontier economy, is there an attempt to pass off unusual operational activity, expenses or advisor relationships as just "how things are done here"?

Most importantly: Is the founder surrounded by a hand-picked team of supporters unwilling or unable to challenge them?

Many of the recent high-profile startup collapses capitalised on the idea that the complexity of the product offering was one of the "magic ingredients" underpinning a high valuation that justified resistance to external scrutiny. But an investible product or service does not rely on confusion, obfuscation or the requirement to be an "insider" to understand its value. In fact, this is a significant red flag; think the Emperor's New Clothes and ask the obvious question.

Accounting controls and compliance

In startups and early-stage companies, the finance function is often immature and frequently lags behind the company's growth, in terms of capability and capacity. Founders tend to be focused on their vision and less worried about the "numbers". Furthermore, the characteristics that make entrepreneurs a success, such as strong and dominant personalities, can misfire if directed to encourage a finance function to "make the numbers work". The absence of a compliance function or framework in early-stage startups further adds to an environment conducive to fraud, should the opportunity and motivation arise. It is no coincidence that in nearly every portfolio company fraud investigated by Kroll, the wrongdoing has been the result of an aggressive CEO founder, who has taken advantage of such a scenario.

The Fraud Triangle can be overused, but the concept is applicable in relation to the risks associated with financials in startups:

- **Opportunity:** Typically, a small function, with limited checks and balances, often very loyal to the founder and unlikely to question their directives
- **Motivation:** Wanting to make the numbers work to prove their thesis or meet aggressive incentivisation plans
- **Rationalisation:** It's my company so my money, and this is only short term while we get through a "blip"

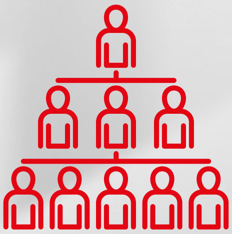
All too often we see a lack of detailed, financial due diligence at an early investment stage, both pre- and post-capital raise, with too much reliance placed on investor presentations and audited financial statements. Even at later stage funding rounds, there tends to be a focus more on testing the financials from a growth and valuation perspective, as opposed to stepping back and testing the veracity of key accounting line items.

Founders should be focused on ensuring that the accounting and financial reporting system they are building, if it is not already fully in place, is sufficiently robust to withstand external scrutiny from third parties seeking to evaluate the credibility of their financial projections and that there is evidence of separation of duties, oversight and documentation of financial processes.

Approach to legal and regulatory risk

A similar temptation to cut corners may be present in legal or regulatory functions when a company is under pressure to chase growth.

It can be argued that, by definition, a disruptive technology or service will push existing legal and regulatory boundaries. But such a business requires sophisticated support to demonstrate that challenges to the "status quo" meet legitimate commercial needs and have not arisen out of ignorance of, or wilful disregard for, applicable laws and regulations in order meet short-term valuation objectives.



A sound incentivisation structure

Setting realistic expectations around product development milestones and revenue growth is key to addressing the temptation a management team may feel to cut corners in order to meet investor KPIs, especially when their personal compensation is closely linked to these goals or required to secure a new round of fundraising.

Where there is a lack of transparency and good communication between the management team and investors, fear can spread that the whole venture could collapse following a period of softer revenue, customer numbers or a setback on the research and development front. This could form the basis of a decision to present performance metrics which evade the truth.

The right sort of optimism

"Fake it till you make it" has become a well-known motto associated with the startup industry. Certainly, such an outlook can provide just the excuse for a management team to rationalise poor decision-making or outright misrepresentation, in an environment in which achieving "unicorn" status—a USD $1 billion valuation—has been viewed as the ultimate goal.

However, the value a thoughtful and engaged investor can bring to a startup through the application of consistent oversight and governance advice cannot be underestimated. This is particularly valid in sectors, including many fields of nascent technology, where formal regulation may not be keeping pace with the scale of entrepreneurial activity, perhaps due to a lack of government investment in supervisory bodies.

The payoff of investment in strong governance structures is not just the avoidance of financial risk or civil and criminal liability, but higher exit valuations and the sort of reputational profile for both the company and its backers that requires no reliance on "faking it."

SETTLING WISELY

CONSIDERATIONS FOR SETTLEMENT IN MULTI-PARTY FRAUD LITIGATION

Authored by: Liz Jones KC (Barrister) - Serle Court

In 2023, the long running case of Kea v Watson (also known as Glenn v Watson) finally came to an end. The final assessment of equitable compensation, after many recoveries, gave rise to practical points of significance in fraud and asset tracing, where a claimant often has to pursue multiple defendants so as to maximise the eventual judgment and recovery.

Glenn v Watson (trial judgment at [2018] EWHC 2016 (Ch)) involved claims to recover some £129m plus interest from a trust company which had entered into a joint venture agreement with Kea Investments Ltd, a company owned by Sir Owen Glenn. The joint venture company was called Spartan, and it had received the £129m. Of that £129m, some £12.5 m had been paid out by Spartan to the principal wrongdoer, Mr Eric Watson, so that Kea had a tracing claim to that money. The bulk of the money was recovered mid-trial when the claimants settled with the trust company after it became clear that one of the relevant contracts was a forgery. The trial continued against Mr Watson and one of his assistants, and Kea succeeded in establishing deceit, bribery and breach of fiduciary duty. The court ordered that Kea was entitled to equitable compensation and ordered an interim payment, accounts as to the tracing claims and an enquiry as to the total equitable compensation once the tracing claims had been dealt with.

In 2023, Kea obtained judgment as to the amount of the equitable compensation: Kea v Watson [2023] EWHC 1830 (Ch). In the meantime, Kea had:

(a) successfully recovered traceable money from various sources, including a US LLC which had bought a NY penthouse, Mr Watson's accounts in banks in Monaco and Switzerland, a trust which had bought a house for one of Mr Watson's former partners, and Mr Watson's assistant, who had been the object of a knowing receipt claim;

(b) settled claims against parties in England, Hong Kong and the BVI in relation to assets which were not traceable but which Kea asserted were being held by those parties as nominees for Mr Watson (relying on the interim payment order); and

(c) settled a claim for damages against a firm of solicitors which had acted for Mr Watson/the trust company.

Kea had to make various allocations and appropriations in order to arrive at the final sum for equitable compensation. The claims against third parties which were settled gave rise to a number of issues which have practical importance when considering settling against any particular defendant.

The principles

If the claimant has claims against A and B and settles against A, the question arises as to how much of the settlement sum received from A the claimant must give credit for in the continuing claim against B. This can make a significant difference to the claim against the continuing defendant, B.

The relevant principles are set out in paragraphs 30-41 of the judgment [2023] EWHC 1839 (Ch), and the application of those principles to the settlement with the solicitors is at paragraphs 102-119. In short, the things to be considered are:

- What claims have been settled against A;
- To what extent the settled claims overlap with the claims against B;
- Whether the court can be satisfied that the claim against A was sufficiently meritorious. (What that means could be the subject of another whole article).

The practical lessons

Four matters follow which need to be borne in mind when settling against third parties.

First, it is best if any settlement agreement expressly provides that the claimant does not allocate or appropriate payments by party A to particular claims against party A, and preserves its right to make allocations against particular claims in the future. That maximises the ability of the claimant to allocate the receipts to claims which do not overlap with remaining claims against the remaining defendants (for example by allocating the recovery to costs claimed against Party A only).

Second, try to avoid entering into confidentiality or non-disparagement agreements with party A which will get in the way of showing the court in the final assessment against party B that the claim against party A was sufficiently meritorious. Ensure that there is always a carve out for putting sufficient evidence before the court on future hearings against party B to prove that the case against party A was sufficiently meritorious. In this case, as appears from paragraph 2 of the judgment, the court was willing to protect some of the confidential information of party A: part of the hearing was conducted in private, orders were made protecting the confidentiality of information (eg under CPR 5.4C), and the judge used descriptions rather than numbers and refrained from identifying certain third parties by name. That may provide some comfort to settling parties that they will be protected even if the claimant has to later prove that the case against them was sufficiently meritorious.

Third, part of the settlement sum can be allocated to the costs of the proceedings against party A, but probably only to a sum equivalent to that which would have been recovered against party A if the claim against party A had been successful (including on an indemnity basis if that can be shown to be likely to have been the outcome of a successful claim).

Fourth, where the claim against party A included a claim for the costs which had been incurred in pursuing party B or perhaps other parties (in this case, against Mr Watson and against Spartan and in recovering traceable assets and against others who had acted as nominees), the receipts from party A by way of settlement can be allocated or appropriated to those claims if there was a sufficiently meritorious claim against party A for recovery of those costs (for example in a claim for negligence; see paragraph 108 of the judgment).

Finally, the case is noteworthy because certain assets had been obtained by Kea from the alleged nominees which assets were not readily saleable. The Judge allowed those to be dealt with on the basis that credit for those assets would be given in the future against the judgment sum when those assets generated cash. How to account for illiquid assets can be a problem, so while the judgment deals with this very shortly at paragraphs [122]- [129] it is well worth bearing in mind.

Liz Jones KC led David Drake and Paul Adams on this part of the case, instructed by Toby Graham and Tom McPhail at Farrer & Co.

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