FIRE STARTERS

Fraud • Insolvency • Recovery • Enforcement

FUTURE THOUGHT LEADERS

page by page towards tomorrow

THE FUTURE THOUGHT LEADERS ESSAY COMPETITION, A FIRE STARTERS GLOBAL SUMMIT SPECIAL EDITION

OUR STORY

We at ThoughtLeaders4 are serious about providing opportunities to up-and-coming practitioners specialising in Asset Recovery, Fraud, Insolvency and Enforcement. We strongly believe that the next generation of practitioners should be writing, speaking and attending events in order to build networks and further their careers.

With this in mind, we are proud to present our Future Thought Leaders Essay Competition. Assessed by an illustriously experienced, senior and broad-ranging panel of practitioners this is your chance to stick your head above the parapet and mark yourself as the oneto- watch. With the opportunity to attend and present your essay at our Global FIRE Starters Summit: Dublin as well as attend our FIRE International: Vilamoura event in Portugal, we look forward to your submissions and to welcoming you to the FIRE Starters community.

THE BRIEF

THE CROSSOVER BETWEEN FRAUD AND INSOLVENCY IN MY JURISDICTION.

We are delighted to invite submissions for papers that discuss the part insolvency processes play in tackling fraud claims in your jurisdiction. We encourage applicants to discuss new legislative changes, how their own toolkit for dealing with fraud claims may have changed, and responded to contemporary global challenges, and cite specific examples and case law. For example, applicants may, if they are from the UK…look at cross-border insolvency in the current post-Brexit landscape, discussing the impact of the Insolvency Rules 2016, as well as the swift legislative action we have seen with the Corporate Insolvency and Governance Act (CIGA 2020). Any updates to bankruptcy, the receivership process and liquidation processes, etc… and maybe even some crystal-ball gazing is also welcome… This is a short paper, and we invite you to be creative, opinionated, and tease out the crossovers between fraud, insolvency, asset recovery and economic change.

fraud
insolvency

A letter from one of our JUDGES

MARK EMERY

Mark is a Director and Advocate at DQ Advocates in the Isle of Man. Mark has experience in acting in commercial disputes (ranging from complex contractual disputes through to issuing proceedings seeking to secure and recover substantial assets such as private jets, yachts and properties held through Isle of Man companies), fraud & asset recovery, corporate insolvency, applications for injunctive relief, enforcing foreign judgments and also in applications to the Isle of Man High Court seeking the recognition of foreign liquidators and trustees in bankruptcy.

This edition of the **FIRE Starters Magazine** is a particularly special one as it follows the first ever **FIRE Future Thought Leaders Essay Competition**. I am proud to have been part of the illustrious judging panel, with the topic of the essays being *"The crossover between fraud and insolvency in my jurisdiction"*. The panel was very pleased to see the amount of submissions in a relatively short period of time, with all creatively approaching the topic from an array of different angles. The quality of essays submitted made choosing a winner very difficult, but ultimately the panel was very pleased to choose **Cailtin Bruce of Collas Crill's** essay ***"Désastre in Paradise – Fraud and Insolvency in Jersey, Channel Islands"***. Caitlin's essay stood out not only for its coherent summary of the law of désastre and the winding-up of Jersey companies, but also with its unique approach in tackling the question by also looking at how Jersey trust law widens the role that insolvency practitioners play in the detection and remedying of fraud in Jersey.

Caitlin not only holds the esteemed title of the first ever winner of FIRE's Future Thought Leaders Essay Competition and receives free tickets to the FIRE Starters Global Summit in Dublin and FIRE International in Vilamoura, Portugal, but will also have a unique opportunity to present a summary of her winning essay at the FIRE Starters Global Summit. This is a fantastic opportunity which I`m sure Cailtin will very much enjoy, and we look forward to hearing more about her essay very soon.

Congratulations are also due to both **James Saunders** at **New Square Chambers** and **David Johnson** of **PCB Byrne**, who came second and third respectively. I'd just like to finish by thanking everyone who submitted essays, which have all been published and can be read in this edition of the FIRE Starters Magazine, together with thanking my colleagues in the judging panel for their valuable time and assistance with judging the competition.

JUDGING PANEL

KEVIN HELLARD
PARTNER,
INSOLVENCY PRACTICE LEADER
GRANT THORNTON

Kevin is the practice leader of Grant Thornton's insolvency practice. He has more than 25 years' experience of contentious insolvency investigating fraud, misfeasance, professional negligence and asset tracing across multiple jurisdictions.

FIONA SIMPSON
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Fiona specialises in civil fraud litigation, advising clients bringing or defending civil fraud proceedings, often involving injunctions and often with an international dimension.

MARCIA SHEKERDEMIAN QC
BARRISTER
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Marcia is a leading practitioner in all aspects of contentious and non-contentious insolvency, company and partnership law as well as commercial litigation.

DANNY QUAH
DIRECTOR
TSMP LAW CORPORATION

Danny is frequently appointed to act in commercial litigation requiring urgent injunctions and as debtor's counsel in dire insolvency situations. He also maintains a specialist tax disputes practice.

YAN KALISH
COUNSEL
RYBALKIN, GORTSUNYAN & PARTNERS

Yan represents clients before arbitral tribunals acting under the rules of various institutions, including ICC, SCC, LCIA, SIAC, VIAC, etc. and in litigations in and outside Russia. He also sits as arbitrator and co-chair's ThoughtLeaders4 FIRE CEE-CIS committee.

MARK EMERY
ASSOCIATE DIRECTOR,
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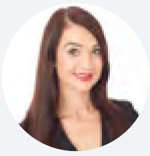
DQ ADVOCATES

Mark heads DQ's Insolvency & Restructuring team and practices a wide range of commercial litigation. He is a member of the "NextGen" Channel Islands & Isle of Man Committee for FIRE.



DR JENNIFER WHITE
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Jennifer has a doctorate in the field of diversity, inclusion and the gender pay gap, and a GDL. She has experience as a judicial clerk at the DIFC Courts, drafting judgments for numerous high-profile and high-value commercial disputes.

FIRE

2022 Upcoming Events

FIRE Elite Circle
21st-22nd April 2022 | Pennyhill Park, London, UK

Tech on FIRE
28th April 2022 | One Moorgate Place, London, UK

FIRE International: Vilamoura
18th-20th May 2022 | Anantara Hotel, Vilamoura, Portugal

QC Surgery: Insolvency
7th July 2022 | London, UK

FIRE Summer School
21st-23rd August 2022 | Downing College, Cambridge, UK

FIRE UK: Welcome Back
22nd-23rd September 2022 | Syon Park, London, UK

FIRE Americas
26th-28th October 2022 | Miami, USA

FIRE Middle East
13th-15th November 2022 | Dubai, UAE

To register for the events and speaking opportunities contact:

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DÉSASTRE IN PARADISE

FRAUD AND INSOLVENCY IN JERSEY, CHANNEL ISLANDS

Authored by: Caitlin Bruce - Collas Crill

Introduction

Enter the search terms *'fraud'*, *'insolvency'* and *'Jersey'* into Google and you are likely to be met with a range of news articles that could be mistaken for Netflix pilot proposals. *'Trouble in Paradise: Family, Feuds and Fraud in Jersey'*[1] and '*The Heiress, the Queen and the Trillion-Dollar Tax Shelter*'[2], are some of the more recent headlines. While this might sound rather glamourous in a Bergerac meets Succession way, as the Guardian's Jamie Doward suggests,[3] other articles report instances of fraud committed against local businesses which hit closer to home.[4] Banks and accounting firms report (perhaps less glamorously) that there has been a significant increase in fraud cases since the start of the COVID-19 pandemic[5] which PwC suggest is typical in periods of economic downturn.[6]

Fraud is a pervasive global problem, and Jersey businesses and individuals fall victim to the same scams and cyber-attacks as their overseas counterparts. But, as an international financial centre responsible for managing billions of pounds in funds and assets which often form part of a global network of companies and trusts, Jersey and other offshore jurisdictions arguably have a heightened sense of responsibility in relation to the detection, prevention and remedying of fraud.

Against this background, this essay discusses the ways in which Jersey's insolvency procedures have developed (and continue to develop) to address fraud claims in Jersey's unique setting. The essay will examine, with reference to case law, fraud in the context of insolvent companies as well as in context of the "insolvent trust" – a developing area of Jersey law. In addition, the essay will briefly discuss judicial assistance in the context of fraud and insolvency.

1 Jamie Doward (15 March 2020), 'Trouble in Paradise: Family, Feuds and Fraud in Jersey', The Guardian, accessed on 6 January 2021, available at https://www.theguardian.com/world/2020/mar/15/jersey-dick-family-trouble-in-paradise-offshore-trusts-court-battle

2 Leah McGrath Goodman (9 March 2021), 'The Heiress, the Queen and the Trillion-Dollar Tax Shelter' The Institutional Investor, accessed on 6 January 2021, available at https://www.institutionalinvestor.com/article/b1qwpnk6j1zv70/The-Heiress-the-Queen-and-the-Trillion- Dollar-Tax-Shelter

3 Doward Op cit. note 1.

4 News desk (14 November 2020), 'Scammers hack building firm's emails and con customer into paying £130k', Jersey Evening Post, accessed on 6 January 2021, available at https://jerseyeveningpost.com/news/2020/11/14/scammers-hack-building-firms-emails-and-con- customer-into-paying-130k/

5 See, KPMG, (4 August 2021) 'Volume of fraud cases hitting the UK has doubled', KMPG Website, accessed on 5 January 2021, available at https://home.kpmg/uk/en/home/media/press- releases/2021/08/volume-of-fraud-cases-hitting-uk-courts-has-doubled.html; and UK Finance (25 March 2021), 'Criminals exploit Covid-19 pandemic with rise in scams targeting victims online', UK Finance, accessed on 5 January 2021, available at https://www.ukfinance.org.uk/press/press-releases/criminals-exploit-covid-19-pandemic-rise-scams- targeting-victims-online.

6 PwC (undated), 'COVID-19: The potential increase of fraud and economic crime', PwC Website, accessed on 5 January 2021, available at https://www.pwc.com/gx/en/issues/crisis-solutions/covid- 19/increased-fraud-economic-crime.html

Fraud and Insolvent Companies

There are several ways in which an insolvent company can be wound up under Jersey law.[7] Principally though, a company will be wound up by way of a creditors' winding up under the Companies (Jersey) Law, 1991 (the Companies Law) or a désastre under the Bankruptcy (Désastre) (Jersey) Law, 1990 (BDJL).

The creditors' winding up procedure under the Companies Law is a misnomer in that it cannot be initiated by a creditor. Instead, it is initiated by way of a special resolution of the shareholders of the company.[8] A liquidator is appointed to wind up the affairs of the company.[9]

The difficulty for creditors is that shareholders cannot be forced to wind up a company.

A director who suspects that the shareholders are guilty of fraudulent activity can apply to the Royal Court of Jersey (the Royal Court) under article 155 of the Companies Law to have a company wound up on just and equitable grounds.[10] Likewise, a shareholder who has lost confidence in the management of the company due to fraud or dishonesty on the part of the directors can apply to the Royal Court under article 155 of the Companies Law. However, the Companies Law does not make provision for a creditor to instigate winding up proceedings.

Draft amendments to the Companies Law have been proposed to introduce a creditors' winding up procedure that is true to its name.[11] The proposed procedure would allow a creditor, with a liquidated claim over £3,000, to apply to the Royal Court to wind up a debtor company.[12] The creditors can nominate a provisional liquidator to be appointed to maintain the status quo between the presentation of the application by the creditor and the making of the winding up order by the Royal Court.[13] This is helpful in the context of fraud prevention if the creditors suspect that the shareholders and/or directors are contemplating committing fraud.

In addition, the creditors can nominate a liquidator to wind up the affairs of the company.[14] By contrast, in désastre proceedings this task automatically falls to and is carried out by the Viscount of the Royal Court of Jersey (the Viscount).[15] Although the Viscount's department is both effective and highly skilled, creditors would have the benefit of choosing a liquidator with specific experience in crypto-currency or tax fraud or ESG scams, for example. It is proposed that non-Jersey resident liquidators may be appointed as joint liquidators to make use of specialist skills that may not be available on Island.[16] As Jersey continues to promote itself as a modern international financial and FinTech centre, it is important that creditors have the benefit of imported skills where necessary.

As it stands though, a creditor with a liquidated debt over £3,000 can apply to the Royal Court to place the assets of the company en désastre under the BDJL.[17] Désastre is unique to Jersey and developed out of the common law as a means of creating fairness among the creditors of an insolvent debtor.[18] Upon a declaration of en désastre the assets of the insolvent company immediately vest in the Viscount who is appointed to realise assets, administer claims and wind up the company.[19]

An important feature of both a creditors' winding up and désastre in the context of fraud claims is the duties of the Viscount or a liquidator, as the case may be, to investigate and report suspected wrongdoing to Her Majesty's Attorney General.[20]The Royal Court has confirmed that the Viscount is under a duty to investigate the circumstances giving rise to the désastre.[21]

In Jobas Limited v Anglo Coins Ltd 1987- 99 JLR 359, the Court held that: -

"As Jersey's standing as an international finance centre grows and the volume of offshore business expands, it is necessary for the insolvency service to respond in a manner that will ensure the continued protection of the public interest.

The actual process of désastre in Jersey has itself become necessarily investigative, for its overriding objective is to safeguard the Island's reputation for commercial integrity and morality"[22]

More recently the Royal Court has recognised that in certain circumstances it may be necessary to expand the normal investigation beyond that necessary to realize debtor's assets.[23] A liquidator would be expected to pursue civil fraud claims to realise a company's assets for the benefit of the creditors, where it is possible to do so. However, investigating a suspicion of criminal fraud on the part of the directors or

7 Dessain & Wilkins (2016) Insolvency and Asset Tracing 5th ed., pg 130.

8 Article 156(1)(a) of the Companies Law.

9 Article 161 of the Companies Law.

10 See, In Re Belgravia Financial Services Group Limited [2008] JLR N 36 at pg 1.

11 Government of Jersey (19 July 2021) Consultation Paper: The introduction of a Creditors' Winding up regime, accessed on 4 January 2021, available at https://www.gov.je/government/consultations/pages/creditorwindup.aspx.

12 Ibid at pg 6.

13 Ibid at pg 8.

14 Ibid at pg 10.

15 Article 8 of the BDJL.

16 Consultation Paper op cit. note 11 at pg 10.

17 Article 3(1) of the BDJL.

18 Dessain & Wilkins op cit. note 7 at pg 135.

19 Article 8 of BDJL.

20 Article 184 of the Companies Law and Article 43 of the BDJL.

21 See, Jobas Limited v Anglo Coins Ltd 1987-88 JLR 359 in respect of the duties of the Viscount in désastre proceedings; and Hotel Beau Rivage Company v Careves Investments 1985-86 JLR 70, in respect of the duties of liquidators in a creditors' winding up.

22 Jobas op cit. note 21 at pg 365 – 366.

23 Viscount v Booth (A.P.) (en désastre) v Investec Bank (Channel Islands) Limited 2018 (2) JLR 253 at para 68.

shareholders would arguably fall within the ambit of exceptional circumstances referred to above.

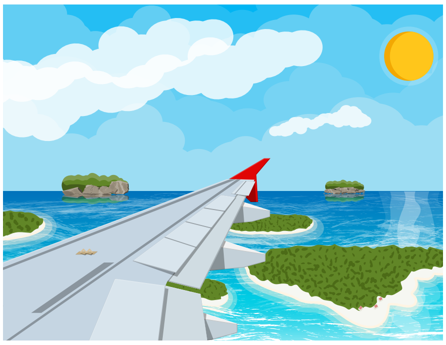
The Viscount and liquidators therefore have an important role to play in the detection and remedying of civil fraud in Jersey but also in the detection and reporting of criminal fraud. By virtue of their position, they have access to company information that is not immediately available to the local authorities. Accordingly, aside from pursuing civil fraud claims for the benefit of creditors as part of the winding up process, the Viscount and liquidators are arguably best placed to detect and report criminal fraud which is in the public interest.

Bust Trusts

As a matter of law, a trust cannot be insolvent as is not a separate legal entity.[24] However, in the case of In Re Z Trusts [2015] JRC 196C the Royal Court accepted the concept of an 'insolvent trust' as useful shorthand to describe the situation where a trust has insufficient assets to cover its liabilities.[25] This case forms part of a wider dispute which has been borne out in a number of hearings before the Royal Court, the Court of Appeal and more recently the Privy Council. In 2021, Collas Crill acted for one of the parties in appeal to the Privy Council against the Court of Appeal's findings in In Re Z II Trust [2019] JCA 106. The decision, which is imminent, is set to finally determine whether a trustee has priority over beneficiaries in relation to the assets of an insolvent trusts.

The concept of an 'insolvent trust' has seen the introduction of insolvency principles in Jersey trust law. Importantly, a trustee of an insolvent trust is required to administer the trust on the basis that the creditors, and not the beneficiaries, have the economic interest.[26]

The insolvency procedure that is evolving in relation to trusts is flexible and responsive to the specific facts of each case. In reaching its decision in In Re Z Trusts [2015] JRC 214, the Royal Court held that it has the discretion to determine the appropriate insolvency regime to implement which is not set in stone.[27] Accordingly, where there is a suspicion of criminal fraud a trustee or insolvency practitioner would arguably have a responsibility to investigate the circumstances of the insolvency beyond that necessary to realize the trust assets as is the case for the Viscount and liquidators in relation to companies. This development in Jersey trust law widens the scope of the role that insolvency practitioners play in the detection and remedying of civil fraud in Jersey and detecting and reporting criminal fraud.



Judicial Assistance and Fraud from Abroad

Often insolvency proceedings that are initiated in Jersey stem from fraud that is committed elsewhere. The Royal Court is able to assist other jurisdictions to remedy fraud claims by recognising foreign judgment debts pursuant to the Judgments (Reciprocal Enforcement) Jersey Law 1960.

In addition, due to Jersey's prominence as an offshore financial centre it is common for foreign officeholders to investigate and gather evidence in Jersey in relation to foreign insolvency proceedings. In this regard, the Royal Court regularly expresses its willingness to exercise its discretion under Article 49 of the BDJL or its inherent jurisdiction to recognise and assist foreign insolvency practitioners to carry out their duties.[28] The Royal Court's willingness to provide judicial assistance is of particular significance in the context of fraud claims which are often complex and committed on a global scale.

Conclusion

As a legal jurisdiction, independent and distinct from the United Kingdom, Jersey has developed its own set of insolvency procedures some of which are unique to Jersey whilst others have been borrowed or adapted from other jurisdictions. As Dessain & Wilkins note:-

> ***"Having old and new procedures sitting alongside each other provides additional tools for particular circumstances which can be a strength rather than a weakness. Those tools do no doubt sometimes need sharpening, but not destroying"[29]***

It has been said above that the Viscount and insolvency practitioners have an important role to play in the detection, prevention and remedying of civil fraud in Jersey by virtue of their duty to investigate the circumstances of an insolvent company to realise assets. However, the Royal Court has also recognised that certain circumstances may exist which warrant an expanded investigation, beyond that necessary to realise assets. It has been suggested above that this category of exceptional circumstances could include suspicions of criminal fraud. The development of insolvency principles in the context of 'insolvent trusts' has arguably expanded the role of insolvency practitioners in relation to detecting and remedying civil fraud as well as detecting and reporting criminal fraud in the context of trusts. These developments are good examples of Jersey having sharpened its tools to respond to global changes. The essay has also briefly discussed the importance of judicial assistance by the Royal Court in relation to fraud that is committed elsewhere and the recognition of the powers of foreign insolvency practitioners in Jersey.

As fraud continues its global rampage it is important that Jersey continues to sharpen and, where necessary replace, its tools by remaining aware of its responsibilities as an offshore jurisdiction as well as the legislative reforms that have been adopted in other jurisdictions to combat fraud.

24 In Re Z Trusts [2015] JRC 196C at para 5.

25 Ibid.

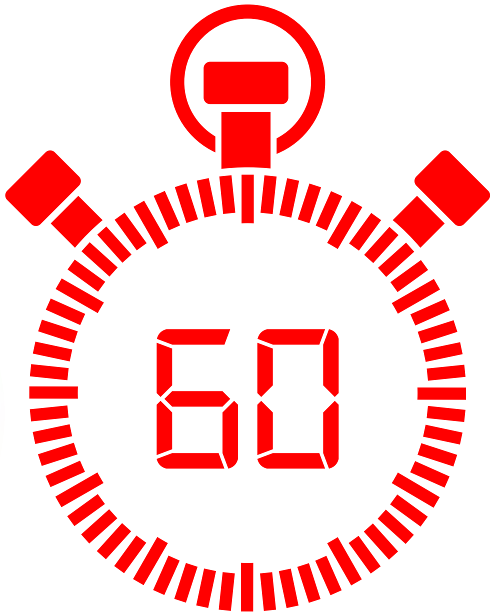
26 Z Trusts op cit. note 24 at para 30.

27 In Re Z Trusts [2015] JRC 214 at paras 26 – 32.

28 See, In re Montrose International [2007] JLR N40; In re F&O Finance A.G. [2000] JLR N5a.

29 Dessain & Wilkins op cit. note 7 at pg 350.

60-SECONDS WITH:



CAITLIN BRUCE
ASSOCIATE
COLLAS CRILL, JERSEY

Q What would you be doing if you weren't in this profession?

A A reunion tour with S Club 7 8.

Q What's the strangest, most exciting thing you have done in your career?

A As a student intern in Johannesburg, trying to stay out of the line of sight when Oscar Pistorius was filmed demonstrating moving without his prosthetics for the Court. (I think my left side has just made the cut on YouTube.)

Q What is the easiest/hardest aspect of your job?

A Writing my to-do list, tidying my email inbox and document management – consistently the easiest tasks in my day and certainly very satisfying in a Zen garden kind of way.

The hardest aspect is learning to be a bit easier on myself for not getting it right. Although learning to manage the expectations of partners and clients in terms of capacity and ability can be difficult, managing your own expectations of yourself is sometimes even more so. It can be very tempting to want (very badly) to get it right first shot and to be very disappointed when it doesn't go that way. However, mistakes make experience and experience makes a good lawyer. Although I have not quite mastered this lesson yet, I feel glad to be at a firm that is very supportive of its juniors in this regard.

Q If you could give one piece of advice to our FIRE Starters (next gen) practitioners, what would it be?

A Be eager and interested. I have been lucky to have worked at firms that place great stock in training and nurturing their juniors. I think that if you show an interest in the work that is going on in the department and put your hand up to get involved or try new tasks wherever you can, you cannot go wrong.

Q What do you think will be the most significant trend in your practice over the next 12 months?

A Although it seems (fingers crossed) that the world is largely on the mend from COVID-19, as things return to a semblance of normal, the period of economic downturn is still not quite at its end. The proposed introduction of a true creditors' winding up procedure in Jersey should stand the jurisdiction in good stead to meet the needs of creditors going forward.

In addition, it may lead to some interesting work in Jersey as the concept of the 'insolvent trust' continues to develop. Collas Crill acts for one of the parties in an appeal to the Privy Council against the Court of Appeal's decision In Re Z II Trust [2019] JCA 106. The decision (which is imminent) is set to finally determine whether a trustee has priority over beneficiaries in relation to the assets of an insolvent trust.

Q If you could learn to do anything, what would it be?

A Sew.

Q What is the one thing you could not live without?

A Cheese and crackers (enjoyed with my friends and family… of course).

Q If you could meet anyone, living or dead, who would you meet?

A Emma Thompson.

Q What songs are included on the soundtrack to your life?

A Mariah Carey – Honey
ELO – Jungle

Q What does the perfect weekend look like?

A Saturday: dinner with friends.
Sunday: lie in, read, brunch, walk, nap, late lunch, read again, Sunday night movie.

Q What are you most looking forward to this year?

A Going back to South Africa (my home country) for the first time in two years – and more travel generally!

THE CROSSOVER BETWEEN FRAUD AND INSOLVENCY IN MY JURISDICTION

Authored by: James Saunders - New Square Chambers

This article focuses upon an emerging trend in insolvency litigation, namely the targeting of directors for their co-officers' breaches of duty. This approach connects with fraud in three ways:

1. It provides a route to establishing liability and recovering where a principal wrongdoer does not provide a suitable target (or in addition thereto).
2. It produces a prophylactic scheme of duties requiring directors to monitor their co-officers, be alive to and prevent misfeasance with particular developments for duties and liability *after* fraud is unearthed.
3. It provides a valuable alternative route to establishing liability where a director is not a direct asset recipient or did not necessarily act dishonestly.

Three themes emerging from recent decisions have reshaped the toolkit for confronting fraud in insolvency scenarios and will continue to do so in the coming years.

1. First, there is a covert revival of the analogy between directors and trustees which continues to impose new and additional duties upon directors.
2. Second, one can see a clear cross-pollination between director's disqualification cases and the broader approach to civil claims. This is likely to expand in the coming year(s) with the reported concern over BBL and CBIL fraud and the claims and disqualifications that will follow.
3. A close link is revealed between the approach to co-director liability, monitoring duties and the imposition of direct tax liabilities upon directors.

I. The Recent Case Law Trend

Before the recent wave of co-liability decisions directors' monitoring duties were chiefly developed in the disqualification arena. Leading authorities applying these principles in civil claims were the decisions in *Madoff Securities International Limited (In Liquidation) v Raven*[1] and *Lexi Holdings Plc (In Administration) v Luqman*[2].

The monitoring duties derived from the disqualification cases have been variously stated but can be summarised as imposing an inescapable personal responsibility to acquire and maintain sufficient knowledge and understanding of the company's business, extending beyond a director's confined area of daily responsibility, and requiring directors to prevent themselves from being dominated or deceived by co-officers.

1 [2013] EWHC 3147 and Re Westmid Packing Services Ltd [1998] 2 BCLC 646

2 [2009] EWCA Civ 117 and see too Briggs J's decision at first instance [2008] EWHC 1639 (Ch)

Directors are entitled to delegate to others and trust their co-officers and are not vicariously liable for their co-officers. The simplicity of this "starting point" belies reality. The two "exceptions" below predominate this "general rule."

First, directors who negligently abrogate their responsibilities by failing to monitor the activities of other directors may be held liable accordingly.[3] Total abrogation will also bar reliance upon S.1157 of the Companies Act 2006 making such delinquent directors a ready target for claims.[4] The supervisory role extends to monitoring lower ranking members of the company to whom responsibilities are delegated, carrying with it the duty to prevent fraud at such levels and possible liability for failing to do so.[5]

Second, if a director who has knowledge of her fellow director's misapplication of company property and stands idly by, taking no steps to prevent it will herself be treated as party to the breach of fiduciary duty by her fellow director in respect of that misapplication by having authorised or permitted it.[6]

These bases of claim have succeeded in recent decisions including *Baker v Staines*[7] and *IT Protect*[8] against the lesser of the culpable parties.

II. The Trustee-Like Liability Revival

Directors are not, strictly speaking, trustees but are in many ways analogous.[9] The above bases of liability and the duties from which they flow, particularly the second have strong parallels with historic trustee liability.

Trustees are required to:

1. Ensure the shared custody/control of trust assets unless sole or minority control is appropriate.[10]
2. Take active steps to *prevent* loss to the trust caused by co-trustees, if necessary by way of injunction.[11]
3. Take active steps to *recover* funds misapplied by a co-trustee.[12]

These duties are tacitly emerging in respect of directors.

The Court in *Baker* held implicitly that a director should have assumed control of a bank account which was held by one director alone in order to prevent misapplications of company funds (category 1).

The Privy Council in Byers v Chen[13] found a director who knows that a fellow director is acting in breach of duty or that an employee is misapplying the assets of the company must take reasonable steps to *prevent* those activities from occurring (category 2).

The Court in *Neville*[14] held that a director who failed to cause the company to call in a co- director's improper loan committed a breach of duty (category 3).

Whereas the development of these duties as regards trustees has been curtailed by now expansive exclusion clauses in trust instruments, the statutory prohibition on exclusions of liability for directors' breaches provides fertile ground for these duties to be developed.

Future Developments

Where may these developments lead for fraud cases? Of the above trustee-like duties it is category 3 which is of greatest interest for insolvency linked fraud claims. Put shortly if an otherwise innocent and ignorant co-director did not negligently fail to prevent fraud and had no knowledge of malpractice but later alighted upon misfeasance and thereafter failed to take all reasonable steps to remedy the position then liability may follow.

As for culpable inactivity the decision in IT Protect provides a prime example of the strict approach to *"causing or allowing"* breaches. The court proceeded in three stages:

1. Firstly, assessing what the unknowing director *ought* to have known if acting in accordance with the knowledge duties built in the disqualification context which set a high bar.
2. Second, after finding that if those duties had been complied with the director would have discovered the breach it was held that the director was also subject to a negative hypothetical "duty" or "irrebuttable presumption" not to be deceived by their co-director. When the conclusion that the director ought to have known of the conduct was established it was thereafter impossible to deny imputed knowledge of that misconduct or to suggest all necessary steps to prevent misconduct would not have been taken.

The common belief that causation is difficult to establish appears to be falling by the wayside with courts prepared to presume that steps that could/should have been taken would have been effective to prevent the misfeasance.[15]

1. Finally, determining what the position would have been if said director had this implied

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3 A s.174 Companies Act 2006 Negligence Breach
4 See Lexi Holdings 2007 EWHC 2652 (Ch) at [224]
5 Sharp v Blank [2019] EWHC 3096 (Ch)
6 The trustee analogy is expressly drawn in Madoff v Raven at [192].
7 [2021] EWHC 1006 (Ch)
8 [2020] EWHC 2473 (Ch)
9 For example for limitation purposes under S.21 Limitation Act 1980
10 E.g. Re Gasquoigne [1894] 1 Ch. 470 and re C. Flower, M.P., and Metropolitan Board of Works (1884) 27 Ch. D. 592
11 Re Chertsey Market (1819) 6 Price 261
12 Brice v Stokes (1805) 11 Ves. Jr. 319
13 [2021] UKPC 4
14 Neville v Krikorian [2006] EWCA Civ 943
15 E.g. the removal of the errant director in Lexi

knowledge and acted to prevent the wrongdoing. The court held the unwitting director should have:

"alerted the bank, changed the codes for online access to the Company's bank account, arranged for the cancellation of any existing bank cards for the account, and arranged for the issue of a new bank card for his sole use, in order to ensure that thereafter, no payments out of the account were made without his informed authority and that all transactions on the account were for the benefit of the Company."

Thus, by the strict application of the knowledge duties to civil claims the courts are developing a framework to hold directors accountable for failing to establish systems to adequately monitor co-directors and share control of company assets. This can readily apply where the chief wrongdoer has committed substantial fraudulent activity, e.g. as occurred in *Luqman*, but where the ignorant director sued has not and may have had no access to assets/accounts as a consequence of the division of responsibilities.

Given the CIGA statutory moratorium on wrongful trading and the likelihood of BBL and CBIL misappropriations having been dissipated by their recipients, IPs and funders will need to look to alternative avenues to maximise recoveries. Co-director claims provide one such avenue. Where companies and their management have undoubtedly been stretched and the degree of mutual oversight likely diminished, the focus will be upon the processes in place to detect and prevent fraud and misfeasance. If such processes are found wanting liability may arise.

Finally, the courts may well see litigation addressing the parameters of what a director must do to satisfy the three "trustee-like" duties above; is there a prospect of success threshold to reasonable action[16], to what extent will the courts investigate asset holding/control arrangements (particularly in small companies)[17], must shareholder-directors act in the former capacity[18] or cause the company to sue? These are but a few of the questions that the court may face when addressing such claims.

III. Direct Tax Liability

Schedule 13 to the Finance Act 2020 can impose direct joint and several liability for company tax obligations upon directors. Condition C requires (as one of two alternatives) that the director *"was responsible (whether alone or with others) for the company entering into the tax- avoidance arrangements or engaging in the tax-evasive conduct," or "took part in, assisted with or facilitated the tax-avoidance arrangements or the tax-evasive conduct."*

This scheme is by no means novel. An analogous regime operates under S.121C of the Social Security Administration Act 1992. Here a director can be held jointly liable for a company's contribution to a range of taxes where payment has not been made. The relevant test is that *"the failure appears to the Inland Revenue to be attributable to fraud or neglect on the part of one or more individuals who, at the time of the fraud or neglect, were officers of the body corporate."*

The scope of *"fraud or neglect"* is wide enough to prevent a director who has no knowledge that obligations have remained unmet, because of a failure to monitor others, from denying responsibility:

"The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done."[19]

It remains to be seen whether *"responsible for"* and *"took part in, assisted with or facilitated"* are interpreted to cover directors standing idly by or failing adequately to monitor but in view of the case law traversed above, the prophylactic duties imposed via co-director liability and the potentially wide meaning of "facilitated" the adoption of a broad approach may not be surprising. If such an approach were favoured it would create a powerful tool to combat tax fraud cases.

CONCLUSION

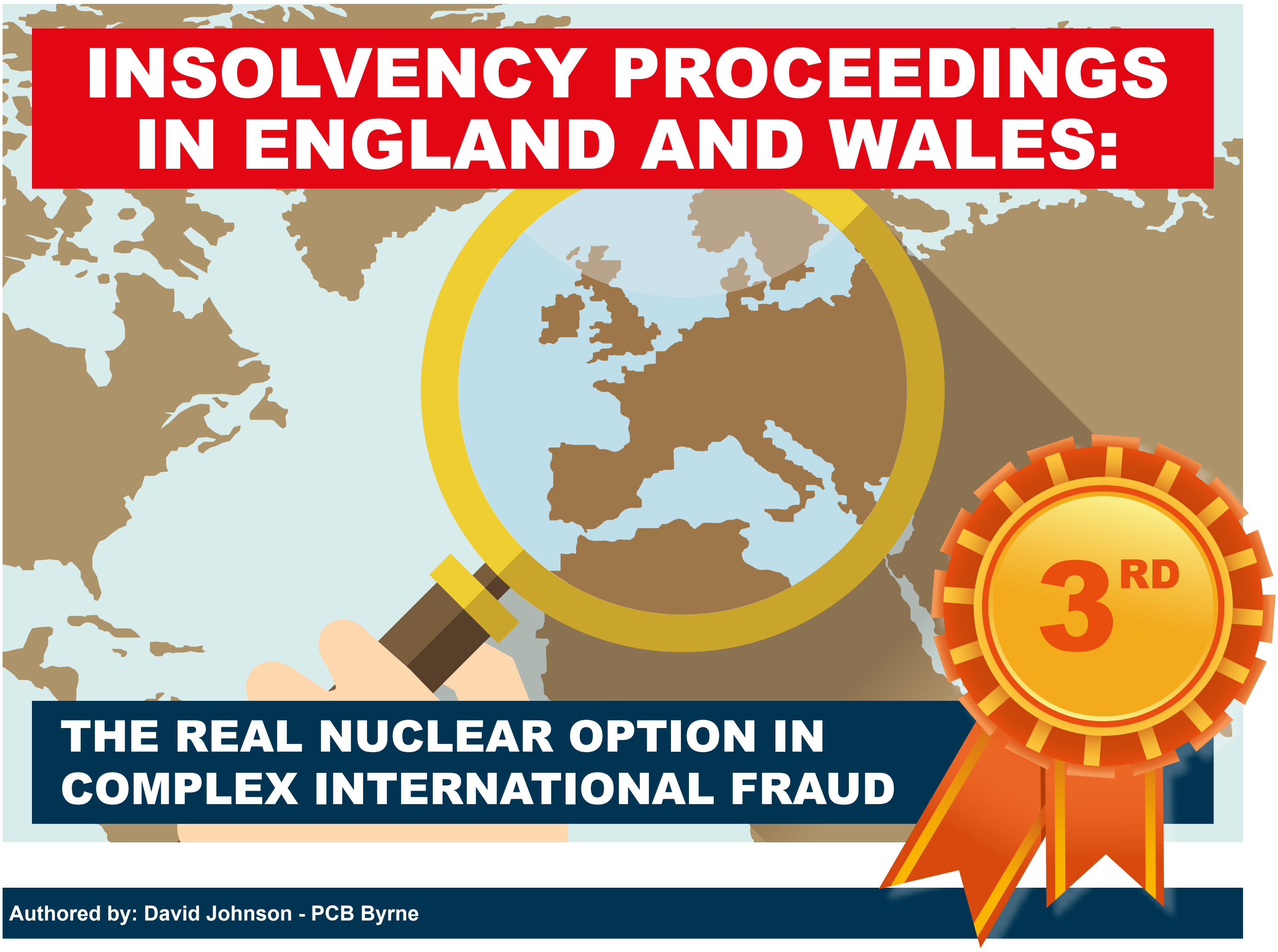
This essay has investigated an emerging theme in modern insolvency fraud litigation surrounding co-directors. The trends are, at least in part, revivals of historic concepts borrowed from trusts litigation and adapted to regulate corporate governance. If the predicted wave of corporate insolvencies and Covid loan-based fraud comes to pass one can anticipate these concepts being deployed and expanded in the coming months and years. If such expansion does come to pass it may also inform (or grow from) the approach to the tools provided by the Finance Act 2020, much to the public purse's benefit.

16 As there appears to be in true trustee cases E.g. Styles v Guy (1849) 1 M. & G. 422 and Millar's Trustees v Polson (1897) 34 SLR 798.

17 E.g. Baker v Staines and contrast Atkinson v Kingsley [2020] EWHC 2913 (Ch)

18 Appearing to be tacitly accepted in Neville v Krikorian

19 Blyth v Birmingham Waterworks (1856) 11 Exch. 781 applied in HMRC v O'Rorke



INSOLVENCY PROCEEDINGS IN ENGLAND AND WALES:

THE REAL NUCLEAR OPTION IN COMPLEX INTERNATIONAL FRAUD

Authored by: David Johnson - PCB Byrne

Introduction

London is a favoured location for sophisticated international fraudsters, both to operate their "business" and to enjoy their success. Misappropriated assets (together with the people who misappropriated them) gravitate here.

Practitioners advising on fraud claims which touch this jurisdiction do well to avail themselves of insolvency options in constructing a recovery strategy: these procedures are powerful weapons for victims to find out what has happened to their money and hold wrongdoers to account.[1]

The following insolvency procedures are particularly useful in the fraud context and each can be utilised with respect to overseas parties if the relevant jurisdictional requirements are met:[2]

1. **Bankruptcy.**
2. **Liquidation (also known as "winding-up") and Provisional Liquidation.**
3. **Administration.**[3]

The point of litigation is to achieve recovery and the aim of fraudsters is to frustrate it. Elegant claims are tissue paper if the cash is not there to pay. This essay focuses on how insolvency proceedings can be used to strategic advantage to: (i) secure assets, and (ii) gather information and documents and trace misappropriated assets.

Securing assets

The use of freezing orders (often referred to as the "nuclear weapon" of litigation, despite being less intrusive than other options) or court appointed receivers, is the go-to option to secure assets. But, to obtain either, an applicant must demonstrate a clear risk the respondent will dissipate their assets.

There is no such requirement for the appointment of an insolvency officeholder. If the debtor is demonstrably insolvent, a liquidator or trustee in bankruptcy may be appointed. The court may appoint an administrator if is it satisfied that the company is likely to become insolvent. If short term depletion of the debtor's assets (by either dissipation or simple

1 As well as providing a platform for civil claims, English insolvency law prescribes offences with sentences of up to seven years' imprisonment for misconduct within insolvency proceeding. Wrongdoers may also face custodial sentences in the course of civil proceedings brought by officeholders, for example, the writer advised liquidators in a case where a company director was sentenced to 18 months' imprisonment for contempt of court, after he fled to Taiwan to move millions between jurisdictions after being served with a freezing order – see Re Changtel Solutions UK Limited [2017] EWHC 1860 (Ch).

2 It is also possible for overseas officeholders to obtain recognition in England, although this essay focuses on domestically appointed officeholders

3 Most practitioners will be familiar with bankruptcy and liquidation. Administration is another form of corporate insolvency procedure (see below). Although administrators can be appointed out of court in some certain circumstances, in a fraud context they will usually be appointed by the court.

mismanagement) is an issue, pending petitions/applications may be expedited, and if the need is there the court will transfer control of the debtor's assets to an officeholder without first giving notice to the debtor (thereby avoiding the risk of "tipping off"), by appointing a provisional liquidator over a company or an interim receiver over an individual's assets.

Administration is the preferred route if the debtor company has a viable trading business, as the administration regime facilitates the trading and sale of such business (protecting goodwill which would be lost in a liquidation), whilst also providing the administrator with broad investigatory powers. The writer has advised administrators in a contentious case involving overseas investors and several trading companies in this jurisdiction, in which the companies were placed in administration, with the underlying businesses being managed and sold as going concerns whilst investigations were progressed.

Even if the risk of dissipation is clear, insolvency proceedings will often be more effective than freezing injunctions or receiverships in securing assets in the medium term, not least because unlike under freezing orders, assets are taken outside the control of the wrongdoers.

In cases of international fraud, insolvency officeholders have a benefit over court appointed receivers as they can utilise cross-border insolvency rules to gain recognition and secure assets (or obtain information for that purpose) in foreign jurisdictions.[4]

Information gathering

The advantages of insolvency procedures are most clearly seen in investigating fraud.

Search orders

English courts grant "search orders" under the jurisdiction established in Anton Piller [1976] Ch 55. However, such orders do not allow an applicant to force entry into the premises, they simply require the respondent to allow the applicant entry. A respondent may disobey the order, or delay compliance and refuse entry; for example, if a respondent holds computers through which they control valuable crypto assets, they may refuse to allow entry to the premises or seizure of the equipment so they can evacuate those assets. Whilst the respondent may be jailed for contempt of court as a consequence, the maximum sentence is two years and many respondents will pay this price to keep their illicit profits.

Section 365 of the Insolvency Act 1986 contains more draconian provisions: the court may issue a warrant for the seizure of the bankrupt's assets and records relevant to the bankruptcy (including those held by third parties). Section 365(2) expressly authorises the use of force in executing such warrants, through the breaking into premises and the breaking open of "receptacles" (for example, safes).

Whilst section 365 (which came into force before cryptocurrency was even a concept) envisaged physical rather than electronic searches, its wording is broad enough to permit the seizure (by force) of electrical equipment, which mitigates the risk of the recalcitrant respondent refusing to surrender that equipment.

Liquidators and administrators may enter company premises and take control of company property without the need for a warrant, an option which is not available outside of the insolvency context. However, with no express provision reflecting the terms of section 365, they cannot realistically break into premises and take assets by force if a respondent is willing to physically intervene. Given the importance in security electronic and digital assets in corporate insolvencies, a statutory search and seize procedure should be available in corporate as well as personal insolvencies, something legislators would do well to implement.

Disclosure orders and examinations

Fraudsters are adept at leaving their victims with as little information as possible, often to the extent that they are unable to identify who has taken their money or where it is and wholly dependent on court-ordered disclosure (often from innocent third parties) to find answers.

Outside of insolvency proceedings, such disclosure is usually obtained under one or more of:

(i) the Norwich Pharmacal jurisdiction[5] (disclosure orders against third-parties "mixed-up" in the wrongdoing), (ii) the Bankers Trust jurisdiction[6] (under which courts will assist a victim in tracing their assets), or (iii) the Court's jurisdiction to order disclosure relating to assets which are (or may be) subject to a freezing order.

However, the court will not permit a claimant to use such orders to conduct a "fishing expedition" whereby broad disclosure is obtained in the hope that evidence of wrongdoing may surface.[7] Conversely, once insolvency proceedings are on foot, officeholders may seek broad disclosure orders in support of their inquiries into the affairs of the insolvent entity or individual:[8]

Pursuant to sections 236 (in corporate insolvencies) and 366 (in individual bankruptcy) of the Insolvency Act 1986, the court may order a person to (i) attend a private examination on matters concerning the insolvent's affairs, (ii) submit a written account of their dealings with the insolvent, and/or (iii) provide copies of documents within their possession or control which relate to the insolvent's affairs.

Also, pursuant to section 133 of the Insolvency Act 1986, the Official Receiver (i.e. the State liquidator in this jurisdiction) may seek an order for the public examination of any person involved in the management of the company.

4 For example, the writer has assisted English liquidators and trustees obtain Chapter 15 recognition in the USA, which provided a platform for obtaining wide-ranging disclosure through which the liquidator traced many millions of previously untraceable funds. This would not have been an option without an insolvency officeholder in place.

5 Norwich Pharmacal Co v Customs and Excise Commissioners [1974] A.C. 133

6 Bankers Trust Co v Shapira [1980] 1 W.L.R. 1274

7 As to Norwich Pharmacal orders, see Ramilos Trading Ltd v Buyanovsky [2016] EWHC 3175 (Comm) at 62; Bankers Trust orders specifically facilitate asset tracing and cannot be used to search for broader evidence of wrongdoing; disclosure orders in support of freezing relief relate specifically to relevant assets and do not allow a defendant to fish for evidence of broader wrongdoing

8 Whilst the orders will allow a broader inquiry, the Court will exercise some caution to ensure their scope is proportionate; Re Akkurate Ltd [2020] EWHC 1433 (Ch).

The Court will refuse an application if the officeholder's need for the information is outweighed by the oppression which would be suffered by a respondent as a consequence of the order.[9] This is a limited *"get-out"*: for example, in Official Receiver v Deuss [2020] EWHC 3441 (Ch), an application for public examination of a 78 year old Bermudan resident was refused, as it was unduly oppressive to *"haul [the respondent] before the court"* during a pandemic, in circumstances where relevant information had not previously been requested and the respondent had offered to provide an affidavit containing the relevant information.

It is essential that officeholders can obtain such orders so as to investigate claims.[10] Most respondents are not 78 and global pandemics are (we hope) rare, and practitioners are often unduly pessimistic as to whether such an order would be granted. Orders can be made against respondents who the officeholder has decided to sue[11] and it is difficult for a respondent to show that an order requiring the simple production of documents and the provision of written explanations (rather than requiring examination) is unduly oppressive.

The weight of authority (including Re Akkurate Ltd [2020] EWHC 1433 (Ch)) suggests section 236 orders cannot be made against parties located overseas; as a consequence of Brexit, officeholders can no longer rely on the EU Insolvency Regulation to circumvent this limitation. The same analysis applies to section 366, which has similar wording and the same historical origin as section 236. Whilst this may cause inconvenience for officeholders seeking disclosure from overseas parties, disclosure may be obtained by other methods:

Bankruptcy, administration and liquidation are "insolvency proceedings" as defined in the UNCITRAL Model Law on Cross-Border Insolvency, so having an English officeholder in office may provide a gateway to recognition and disclosure in jurisdictions enacting the Model Law or similar legislation.

The English court may order the examination of overseas parties in their current location, provided that procedural mechanisms are in place which would allow such an order to be enforced (see Re MF Global UK Ltd [2015] EWHC 2319 (Ch) and sections 237(3) and 367(3) of the Insolvency Act 1986).

Directors of a company are duty bound to co-operate with liquidators/ administrators, including by attending interviews which are reasonably required to do so[12] and, as Lord Toulson and Lord Hodge JJSC affirmed in Bilta v Nazir [2015] UKSC 23: *"parliament could not have intended that a person who had been responsible for the state of affairs of a company could escape liability to be investigated simply because he was not within the jurisdiction"*. That duty can be enforced without recourse to section 236, pursuant to r.12 of the Insolvency Rules 2016.

Section 133 has extraterritorial effect, so public examination may in principle be ordered against overseas parties involved in the management of the company.

Conclusion

Insolvency procedures are an essential part of the asset recovery arsenal and offer harder edged and more effective strategy options to practitioners seeking to unravel complex, sophisticated frauds.

9 Cloverbay Ltd v BCCI [1991] Ch. 90

10 Re Hellas Telecommunications (Luxembourg) II SCA [2013] 7 WLUK 774 at [11]

11 See the speeches of LJJ Browne-Nicholson and Nourse in Cloverbay

12 Section 235 Insolvency Act 1986

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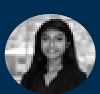

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THE SUPREMACY OF THE CREDITOR IN THE CAYMAN ISLANDS

Authored by: Annalisa Shibli - Collas Crill

Introduction

Fraud may take many forms, but the perpetrators almost inevitably leave their victims financially compromised at best and, in the worst-case scenario, hopelessly insolvent. The Cayman Islands' insolvency regime is well placed to respond in these circumstances by providing for the appointment of liquidators (including provisional liquidators) with the principal objective of recovering or protecting assets of value where they exist.

The most appropriate strategy for protecting the assets which have been subject to fraudulent conduct depends on the circumstances of the fraud, the identity of the perpetrator and the role of the perpetrator in the company's business (if any). Importantly, fraud is not always fatal and, in some cases, liquidators can be appointed on a provisional basis to facilitate the restructuring of the affected entity's debt, allowing it to continue as a going concern.

One of the fundamental tenets of Cayman Islands insolvency law is that once an entity is insolvent, the interests of its creditors take precedence over all other stakeholders. This can have the effect of limiting the recovery of other parties who may have incurred losses because of the fraud. This is especially so for investors who fall victim to fraud after investing in mutual funds.

This essay will discuss the types of fraud seen most often in this jurisdiction; some of the tools available to Cayman Islands' liquidators to navigate scenarios impacted by fraud; and the limitations on the ability of certain victims of fraud to recover misappropriated assets. The discussion will ultimately illustrate that in the Cayman Islands' insolvency regime the creditor reigns supreme.

Categories of Fraud

The legal infrastructure in this jurisdiction, including its tax neutrality, attracts big business. The Cayman Islands is one of the most popular jurisdictions for the incorporation of mutual funds, and multi-jurisdictional businesses are often structured with a Cayman Islands holding company.

As a result of the nature of the business transacted in the Cayman Islands, and the volume and value of trades transacted, the jurisdiction has, in recent years, been at the centre of many high value fraud cases.

The most common types of fraud can generally be classified as either "internal" or "external" fraud, but where there are multiple instances of fraud it is possible for one matter to straddle both categories.

External Fraud

External, or counterparty fraud, occurs where the fraudulent act arises in the context of an arrangement or transaction between an entity and an unrelated party, where one party promises to do something, but takes a course of action contrary to the contractual arrangement.

A common example of this type of fraud is where an investment has been made in a mutual fund which is then employed as part of a Ponzi scheme. The term 'Ponzi Scheme' has become synonymous with the notorious fraudster, Bernie Madoff. Multiple investors in Bernard L Madoff Investment Securities LLC (BLMIS) were Cayman Islands incorporated investment vehicles, whose sole asset was an interest in the BLMIS Ponzi Scheme. After the fraud was discovered, it became apparent that those investment companies where operating based on fictitious net asset values (NAV) and were therefore not able to satisfy the redemption requests of their investors which inevitably followed.

Internal Fraud

Internal fraud, on the other hand, is when the fraudulent act originates from within the relevant entity. In cases of internal fraud, the perpetrator is often part of the entity's management team with intimate knowledge of the details and workings of the business.

One recent example of this is the case of Re Luckin Coffee Inc.. In that case, the discovery of certain accounting irregularities during the audit of the financial statements of Luckin Coffee Inc. (Luckin Coffee), the Cayman holding company of one of the People's Republic of China's (PRC) major coffee chains, led to the dismissal of, among others, that company's chief operating officer and chief executive. There, employees had fabricated sale transactions and manipulated costs and expenses such that Luckin Coffee's net revenue had been fraudulently inflated by approximately US$310 million.

The subsequent public admission in relation to the fraud by certain of its employees led to Luckin Coffee becoming the subject of numerous legal, regulatory and investigative actions spanning multiple jurisdictions, including the presentation of a winding up petition in the Cayman Islands.

The Tools for Recovery

In responding to fraud, the Cayman Islands Companies Act (2021 Revision) (the Act) provides for liquidators with wide ranging powers to assist with the recovery of the company's assets and the associated investigations. The circumstances of the fraud and its discovery will be key in determining whether provisional or official liquidation is preferable, which will impact the powers available to the liquidators.

Official Liquidation

Official liquidators are appointed in circumstances where a company is irretrievably insolvent and the ultimate objective is to collect the company's remaining assets, distribute them to the company's creditors and wind up the company's affairs. The powers of the company's directors cease, and the liquidators take control of the company.

Under the Act liquidators can bring proceedings to challenge transactions which occurred prior to the presentation of the winding up petition in circumstances where the transaction is a voidable preference or a disposition at an undervalue. If, during the winding up, it appears that any business of the company has been carried on with the intent to defraud creditors or for any fraudulent purpose the liquidator may apply to the Court for a declaration that any persons who were knowingly party to the fraudulent conduct are liable to make contributions to the assets of the company.

In addition to their statutory clawback powers, liquidators have the right to pursue or defend litigation on behalf of the company to which they have been appointed. One of the most notable examples of this in the Cayman Islands is the decade long, multi- billion-dollar Saad litigation. The fraud in that case was allegedly perpetrated by Maan Al Sanea (MAS) who had married into the Algosaibi family. AHAB, a Saudi Arabian partnership owned by the Algosaibi family, claimed that MAS used his managerial control of the Money Exchange, a division of AHAB, to defraud AHAB.

The fraudulent transactions involved misappropriating over US$4 billion from the Money Exchange and funding those misappropriations by causing AHAB incur approximately US$9.2 billion in unauthorised debt. The recipients of those funds were said to be Cayman Islands incorporated companies that were sued by AHAB for restitution, damages and compensation, as well as knowing assistance and knowing receipt. Those companies found themselves the subject of winding up petitions brought by the affected lenders and were ultimately placed in official liquidation. The relevant liquidators successfully defended the claims brought by AHAB in the Cayman Court.

All steps taken during official liquidation proceedings are ultimately for the benefit of the company's creditors who, unlike investors, have the financial interest in the liquidation estate. Though they do not dictate the liquidation strategy, which is ultimately decided by the Court appointed liquidators, creditors are in practice very influential in determining the course of the liquidation. This often takes the form of participation in the company's liquidation committee which, for insolvent companies, is comprised of not less than three or more than five creditors.

Provisional Liquidation

Provisional liquidators are often appointed where a company is in the zone of insolvency, but not hopelessly insolvent, for the purpose of presenting a compromise or scheme of arrangement to creditors. To qualify for this relief, the company must be, or be likely to become, unable to pay its debts. It is therefore important that, once provisional liquidators have been appointed, there is an automatic stay on the commencement or continuation of proceedings against the company.

Though provisional liquidation with a view to debt restructuring is generally more flexible than official liquidation, the restructuring will not succeed without the support of the company's creditors. To be approved by the Cayman Islands Court, a scheme must be supported by at least 50% in number representing 75% in value of the creditors whose rights are being compromised. A scheme of arrangement was recently agreed, in the context of the Luckin fraud, between Luckin Coffee and its creditors using the provisional liquidation mechanism.

It is worth noting that provisional liquidation can also be used to protect the assets of a company where fraud is suspected. The applicant for this relief must illustrate that there is a prima facie case for making a winding up order and the appointment is necessary to, among other things, prevent (i) the dissipation or misuse of assets; or (ii) mismanagement or misconduct on the part of the company's directors.

Limitations on Recovery

In addition to the points raised above about creditor influence on liquidations, the Companies Act provides that secured creditors retain the right to enforce their security in satisfaction of the secured debt without reference to the liquidator. If the sale proceeds realised from a secured asset are insufficient to discharge the outstanding debt, the secured creditor can make a claim in the liquidation as an unsecured creditor for the balance of the debt.

The supremacy of creditors' rights is arguably problematic for investors of a fund that has been the subject of a fraud. As upheld by the Judicial Committee of the Privy Council in the BLMIS case[1], investors who redeem before the scheme collapses, may effectively escape without loss, and in some cases with a windfall, if their redemption payments are based on the fraudulent NAV. Investors who fail to redeem in time will recover subject to the interests of the fund's creditors, who may in fact be redeemed investors who remain unpaid.

The Privy Council opined that the critical moment is when the investor redeemed, ceased to be a member of the fund and became a creditor, following which "the tree must lie as it falls"[2].

The existence of fraud gives rise to a number of difficulties in relation to the calculation of NAVs and the subsequent distributions to the affected stakeholders. The Court has held that an investor's entitlement to redeem its investment under the constitutional documents of a fund, thereby becoming a creditor, trumps any notion that where there has been a fraud the available funds should be shared between affected investors.

Once the status of a stakeholder is determined, the rights of recovery against an insolvent fund may turn on whether the fraud that led to insolvency is properly characterised as external or internal. In a case like BLMIS where the fraud originates externally, underlying investors face the risk of being left out of pocket if they do not redeem before the scheme is discovered. This is because the fraud was perpetrated on the investment entity as a whole and is deemed to be a commercial risk consciously accepted by that entity's investors. Conversely, where the fraud is internal, that is perpetrated by the company itself against its investors, it might be possible for the liquidators to recalculate the NAV and make distributions based on genuine asset values.

Conclusion

The Cayman Islands insolvency regime provides liquidators with robust powers to recover misappropriated assets. The purpose is primarily to swell the assets of the insolvent estate for the benefit of its creditors. In the mutual funds context, investors who fail to validly redeem prior to the discovery of a fraud are not categorised as creditors, with the result that affected investors are generally unable to obtain compensation through the liquidation regime. One could argue that this risk comes with the territory of mutual fund investments but it is clear that, irrespective of the underlying circumstances, when fraud leads to insolvency in the Cayman Islands it pays to be a creditor.

1 Pearson v Primeo Fund [2017] UKPC 19

2 Ibid, at paragraph 18, per Lord Mance

THE CROSSOVER BETWEEN FRAUD AND INSOLVENCY IN MY JURISDICTION

Authored by: Kerri Wilson - Fieldfisher

Having practised law in both the UK and South Africa, I have had the benefit of being exposed to matters involving insolvents on home soil and abroad as well as creditors having to trace assets in foreign jurisdictions. This has also made the transition from practising in one jurisdiction to another, an easy one. Although South African insolvency law has origins in both Dutch and English law it has adopted the English procedure.

Although this essay will deal predominately with English law, it will touch on certain elements of the South African legal jurisdiction.

In order to understand the crossover between fraud and insolvency, in most jurisdictions, one needs to start at the beginning. We have all heard the saying "chicken or egg". This paradox was first proposed in Ancient Greece to describe the problem of determining cause-and-effect. You might be wondering what ancient philosophy has to do with the topic under discussion but, by the end of this essay, you will understand that fraud and insolvency are no different to the ancient "chicken and egg".

The Oxford Advanced Learner's Dictionary defines Insolvency as "the state of not having enough money to pay what you owe…". Fraud, on the other hand, is defined as "the crime of cheating somebody in order to get money or goods illegally".

Taking this one step further, the word bankrupt's, which we know to be a synonym of insolvent, derivation (banca rupta) goes back to medieval times, when the custom of breaking a banker's or tradesman's bench took place if he/she had absconded with the money or goods of his/her creditors. Although it may seem rather harsh, bankrupts have always been seen as the bad guy, or rather villainous in medieval times.

Fraud dates back centuries. The first recording of insurance fraud dates back to 300 BC, in Greece, when two men, Hegestratos and Xenothemism, attempted to con the insurers of a shipload of valuable goods by attempting to sink their boat. The first case of financial fraud, dates back to 193 AD, at the time of the Roman Empire, when the Praetorian Guard attempted to sell rights to the royal throne to the highest bidder even though they did not own the throne. In the 1920s we were first introduced to the Ponzi Scheme, and in later years we saw various investment frauds, including the likes of the Bernard Madoff and R. Allen Stanford investment fraud.

Unfortunately, when individuals and businesses get into financial difficulties and face bankruptcy/insolvency an increase in fraudulent activity is often seen.

Fraud is often at its most virulent during downturns and crises - both of which we now face given the COVID-19 pandemic.

PwC's latest Global Economic Crime Survey found that economic crime reached its highest level in the past 24 months, with 56% of UK businesses stating that they were impacted by fraud, corruption or other economic crime.

This, I am afraid, holds true for the South Africa market as well, as the research has demonstrated that times of political uncertainty, such as that which we are presented with as a result of, amongst other things, the COVID-19 pandemic, often opens up new opportunities for fraudsters to pinpoint or exploit gaps in controls.

As with most economies, the English government found various ways in which to inject capital into the economy in an attempt to stave off the negative impact of the COVID-19 pandemic. Various loans, grants and ways of funding came to light. These included bounce back loans, the retail, hospitality and leisure grant fund as well as the furlough scheme. Owing to the volume of applications and timing pressures, fraudsters used this as an opportunity to demonstrate their villainous ways. As an example certain employers claiming under the furlough scheme had recorded details of employees who were not placed on furlough or, worse, no longer in employment at the time of the application. I pause to mention that it is in times of pressure that company's often find themselves delving into the murky waters "right and wrong".

Desperate times call for desperate measures.

With the increase in insolvencies on the horizon, there is no better time than now to understand what options are available in situations where a creditor has been exposed to fraudulent activities.

Fortunately, both the English Insolvency Act 1986 ("IA") and the South African Insolvency Act, 24 of 1973 ("SA Act") provide the opportunity through the office holder to effectively investigate the causes of the insolvency and gather information about the assets of the insolvent. It is at this stage that certain fraudulent activities are uncovered. The office-holders are also provided with a number of routes to recover the proceeds of the said fraud.

Frauds on creditors may be divided into three basic types. The first consists in incurring debts which the debtor has no intention of paying or does not expect to be able to pay. The second type of fraud consists in the evasion of debts already incurred, innocently or otherwise. The third type involves dishonesty and concealment in connection with insolvency proceedings. This type of fraud also includes the so-called "phoenix company" fraud, dubbed as such in Re Centrebind Ltd [1967] 1 W.L.R. 377, in which the directors of an insolvent company set up a new company to buy the stock and plant of the insolvent company at an undervalue.

One of the common frauds perpetrated when dealing with companies, particularly those on the brink of insolvency, is the concealment or disposal of company property prior to the company being wound up. In terms of section 206 of the IA 1986, if a present officer of the company has, within the 12 months immediately preceding the commencement of winding up, amongst other things concealed any part of the company's property, or concealed any debt due to or from the company; or has fraudulently removed any part of the company's property, he or she will be guilty of an offence under the IA 1986. In terms of section 207 of the IA 1986, an offence is also deemed to have been committed if a person, who was at the time an officer of the company, has not more than five years before the commencement of the winding up, made any gift or transfer of, or charge on, the company's property or concealed or removed any part of such property since, or within two months before the date of any unsatisfied judgement or order for the payment of money obtained against the company. These offences should be reported by the office-holder (i.e liquidator/administrator) to the Secretary for Business Energy and Industrial Strategy and are triable either way, and punishable on conviction on indictment with two years' imprisonment. Although this might bring comfort in knowing that a fraudster can face punishment, the reality is that the creditors of an insolvent company would far prefer funds to flow. As such, a civil claim should be considered under sections 238 and 239 of the IA Act.

Where a company has entered into a transaction with any person at an undervalue, an office-holder can approach the court for an order setting the transaction aside in terms of section 238 of the IA 1986. Such a transaction will take place if the company makes a gift and in exchange for the making of such gift receives no consideration or the company enters into a transaction for a consideration the value of which is significantly less than the value of the property provided. The order will not be made if the company entered into the transaction in good faith and for the purpose of carrying on business, and at the time of doing so it had reasonable grounds for believing that the transaction would benefit the company.

Section 239 of the IA 1986 applies when a company has given a preference to any of its creditors or a surety or guarantor for any of the company's debts or other liabilities, and the company does anything or suffers anything to be done which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will

be better than the position he would have been in if that thing had not been done. In order to succeed with this claim, the office-holder must prove, on a subjective basis, that the company, when deciding to give the alleged preference, desired to produce the effect of the preference (unless the person is connected to the company).

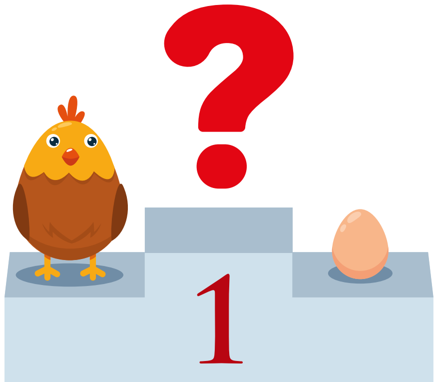
In addition to the above, section 213 of the IA provides an alternative remedy. If in the course of the winding up of a company, it appears that any business of the company has been carried on with the intent to defraud creditors, or for any other fraudulent purpose, the office holder can seek a court declaration that anyone who was knowingly party to the fraudulent business make a contribution to the company's asset. However, only those who were knowingly parties to the fraudulent trading will be liable under section 213.

In order to succeed with this claim the office holder will need to establish "actual dishonestly, involving…real moral blame", as was decided in Re Patrick and Lyon Ltd [1933] Ch 786.

It could even be said that this section was drafted with the actual "bad guy" in mind.

As stated above, desperate times call for desperate measures. Although this essay is focused on the villain, one must not lose sight of the fact that an innocent can become a "bad guy" when he / she feels like they have no alternative. The Association of Certified Fraud Examiners discussed the Fraud Triangle, a model explaining the factors that cause someone to commit fraud. They explain that the components to look out for are pressure, opportunity and rationalization. As insolvency specialists, it is important to bear this in mind. The director sitting across from you may very well be stuck in the Fraud Triangle. Although insolvency may not be reversible, a fraud can be prevented before it has even begun.

At the beginning of this essay I referred you to the Ancient Greek paradox of the chicken and egg. What I have discovered in preparing this essay is that financial problems are mostly always the root to fraud. Insolvency or Fraud? Which comes first?



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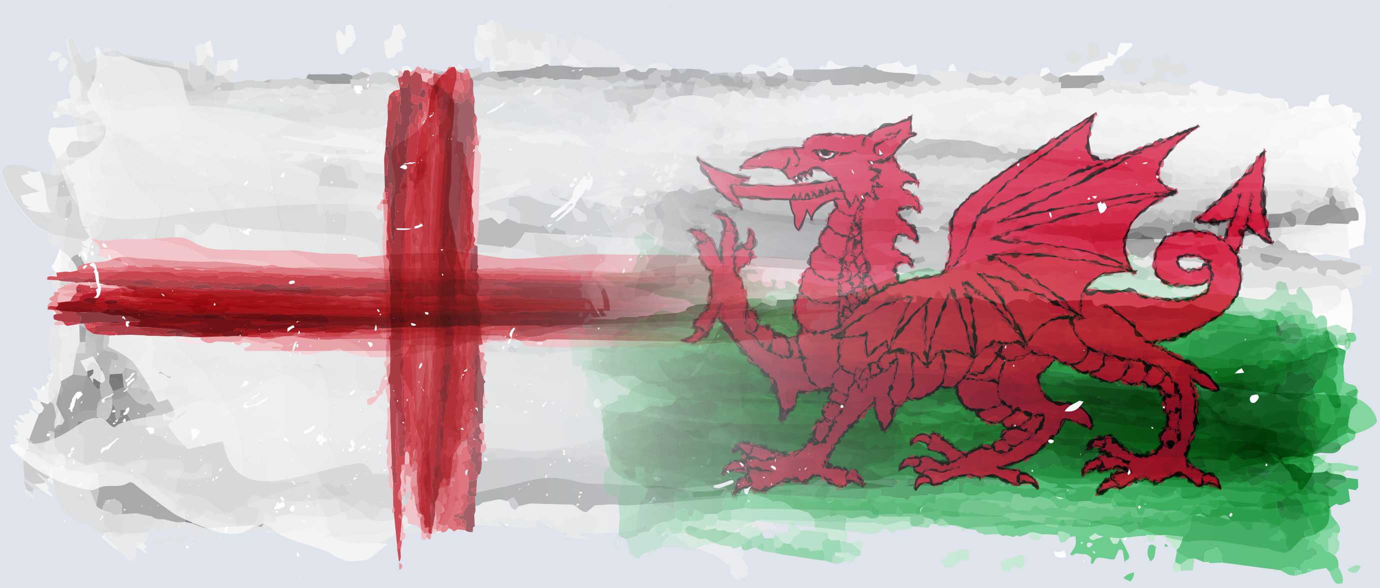
THE CROSSOVER



BETWEEN FRAUD AND INSOLVENCY IN MY JURISDICTION

Authored by: Luke Harrison - Keidan Harrison

1. In England and Wales fraud and insolvency often cross paths.

That is not to say all insolvencies involve an element of fraud or all frauds lead to insolvency but the confluence of fraud and insolvency all too often involve either fraud precipitating insolvency or insolvency uncovering fraud.

In this essay the author examines the interrelationship between fraud and insolvency in three main areas. Firstly, insolvency proceedings as a class remedy to tackle fraud. Secondly, the powers and tools available to insolvency practitioners to pursue fraud claims post-appointment. Thirdly, the Court's inherent jurisdiction and interstitial law-making in fraud cases arising out of insolvent estates.

Insolvency as a class remedy to tackle fraud claims

2. England and Wales are in the grip of a fraud epidemic. Estimates from the Crime Survey for England and Wales showed that in the year ending June 2021 there was an increase of 32% in reported fraud offences compared to the year ending June 2019[1]. The banking and credit industry are, perhaps unsurprisingly,[2].

3. It is not uncommon, however, for banks and financial institutions to find themselves as one of many creditors of the fraudsters or the corporate entities deployed by the fraudsters to distance themselves from the frauds. Acting alone in pursuing those responsible will often be disproportionately expensive and may not result in recoveries if conventional Civil Procedure Rule (**"CPR"**) Part 7 proceedings are deployed.

The reasons include:-

a. The amount of the Court fees on issue of a claim which is 5% of the sums in issue capped at £10,000 for claims over £200,000.

b. That key evidence which supports the fraudulent intent behind a transaction is held with the fraudster or their corporate vehicle.

1 Crime in England and Wales: year ending June 2021: Office for National Statistics: https://www.ons.gov.uk/peoplepopulationandcommunity/crimeandjustice/bulletins/crimeinenglandandwales/yearendingjune2021#fraud

2 Crime in England and Wales: Appendix tables: Year ending June 2021 dataset: https://www.ons.gov.uk/peoplepopulationandcommunity/crimeandjustice/datasets/crimeinenglandandwalesappendixtables

c. The proceeds of the fraud invariable move on from fraudster or their corporate vehicle to third parties meaning that often a Part 7 judgment will be a pyrrhic victory.

d. If acting outside of the insolvency process victims of the fraud may find themselves competing with other victims and creditors trying to recover the same assets.

4. By opening insolvency proceedings, whether by issuing a petition[3] or appointing administrators[4], victims of fraud unite with other fraud victims and other creditors under a common purpose of recovering assets for the benefit of creditors of the fraudsters or their company.

The powers and tools available to insolvency practitioners to pursue fraud claims

5. Insolvency practitioners appointed either as trustee in bankruptcy, liquidator or administrator are in a unique position to pursue recoveries arising out of fraud. Firstly they, for all intents and purposes, become the bankrupt fraudster or an office holder of the fraudster's company. Unlike a fraud victim peering into the window of the fraudster's home insolvency practitioners are invited by the Court to go inside. This enables them to realise those assets that are readily available and riffle through the fraudster's desk draws to find information that will potentially enable them to pursue claims either to recover assets or against third parties leading to recoveries being made for the insolvent estate.

6. In the context of personal insolvency the property of the bankrupt[5] vests in his or her trustee in bankruptcy. In corporate insolvency the property of a company falls under the control of the office holder. More crucially, however, office holders have substantial powers to compel a wider range of third parties to provide them with information. In the context of personal insolvency the powers extends to the bankrupt, their spouse[6] or any person cable to give information concerning the bankrupt or their dealings, affairs or property[7]. In the context of corporate insolvency the powers apply to officers of the company and any person capable of giving information concerning the promotion, formation, business dealings, affairs or property of the company[8].

7. In practice office holders regularly use these powers to obtain information and documents from third parties, very often creditors, financial institutions and professional advisors, without the need for compulsion by the Court. Where an application to the Court is made the Court may order the filing and service of a witness statement dealing with office holders enquiries[9]. In the event of noncompliance with the Court's orders the Court has the power to authorise the arrest of the individual concerned and seize books, papers, records, money or goods in their possession[10]. Further an office holder making an application would usually obtain an order for their costs of doing so from the respondent.

8. The office-holder's powers can be contrasted with the limp powers afforded to creditors and would be litigants to obtain pre-action disclosure. Most fraud claims will not fall under the terms of any Pre-Action Protocol to the Civil Procedure Rules. In the circumstances the Practice Direction – Pre-Action Conduct and Protocols (**"PDPACP"**) would apply. It does not contain any right to pre-action disclosure[11]. The right to apply for pre-action disclosure is set out in CPR Part 31.16[12] and involves a two staged test. Firstly, the Court needs to assess whether or not it has jurisdiction[13]. The Court then considers whether or not to exercise its discretion. The usual rule on an application for pre-action disclosure is that the respondent's costs are paid by the applicant.

9. The information that can be obtained by an office-holder is far wider in scope than that which can be obtained by way of pre-action disclosure. Further the office holder does not need to show that the information is required for the purposes of proceedings. In the context of a fraud the breadth of information that may form part of an investigation and the relative ease with which it may be obtained substantially increases the prospects of obtaining evidence to support meritorious claims. Office holders and their teams further are adept at managing and forensically analysing large quantities of unstructured data. Finally obtaining the information is generally more cost effective and does not come with adverse costs liability.

3 Bankruptcy in the case of an individual or winding-up in the case of a company pursuant to the conditions being satisfied in 267 Insolvency Act 1986 ("the Act") (bankruptcy) or section 124 of the Act (winding-up).

4 Via the out of court process under paragraph 18 of Schedule B1 of the Act or by way of a court application under Paragraph 12 of the Act.

5 Section 283 the Act.

6 In addition to their former spouse, civil partner or former civil partner.

7 Section 366(1) the Act.

8 Section 236(2) the Act.

9 Section 236(2)(3) and 366(1) of the Act.

10 Section 236(5)(b) and (6) and 366(3)(b) and (4) of the Act.

11 Paragraph 6 of PDPAC only provides that disclosing key documents relevant to the issues is a usual pre-action step.

12 The ultimate statutory authority is Section 33(2) Senior Courts Act 1981 as held in Black v Sumitomo Corporation [2001] EWCA Civ 1819 if the case is in the High Court or Section 52(2) of the Court Court Act 1984 as held in EUI Ltd v Charles [2018] Lexis Citation 103 if the case is in the County Court.

13 The Court considers whether the four conditions under CPR Part 31.16(3)(a)-(d) have been met. Namely (a) whether the respondent is likely to be party to subsequent proceedings (b) whether the applicant is also likely to be subject to proceedings (c) whether if proceedings had started the respondent would be obliged to disclose the documents by virtue of standard disclosure at CPR Part 31.6 and (d) whether pre-action disclosure is desirable to (i) dispose fairly of anticipated proceedings and (ii) assist the dispute to be resolved without proceedings.

The Court's inherent jurisdiction and interstitial law-making

10. Despite being a common law jurisdiction the insolvency regime in England and Wales is largely codified in both the Insolvency Act 1986 ("the **Act**") and the Insolvency (England and Wales) Rules 2016 ("the **Rules**"). The Act and the Rules regularly leave decisions to judges, often Insolvency and Companies Court Judges, who have a wide range of discretion. One need only look at the antecedent transaction provisions[14] or wrongful training liability[15]. The Court has wide ranging power in antecedent transaction claims to *"make such order as it things fit*[16]" and in wrongful trading claims to order a director of the company to *"make such contribution (if any) to the company's assets as the court things proper.*[17]"

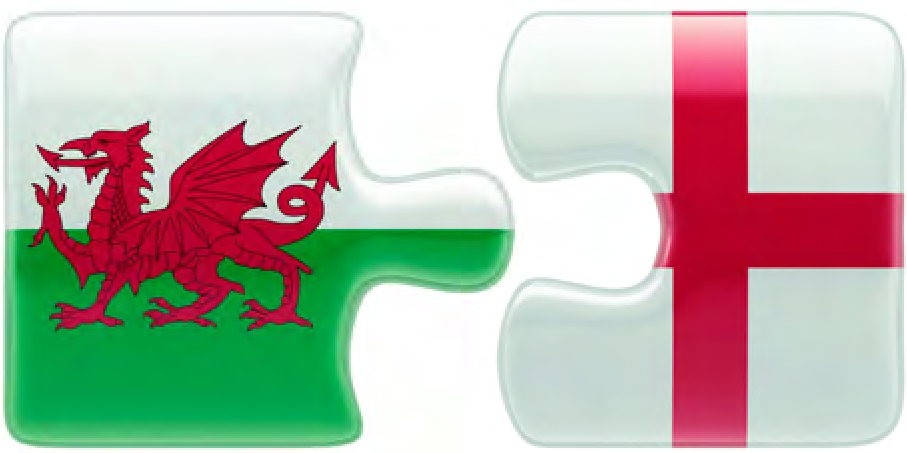
11. The creation and use of interstitial spaces in the law is a key feature of a common law jurisdiction. They leave judges able to develop the common law based on fact specific circumstances and public policy. Interstitial decisions form part of the Court's inherent jurisdiction. Speaking extra judicially[18] Chief Insolvency and Companies Court Judge Briggs noted that the court's inherent jurisdiction had been used in 100 judgments in 2017. Ferrere Lamer[19] describes inherent jurisdiction as *"power born out of the realisation that no one can codify all solutions to human problems in advance of occurrence."* Briggs remarks that inherent jurisdiction is the source of the power for the exercise of interstitial decisions.

12. Causes of action that vest in office holders are a mix of pure insolvency claims, like the antecedent transaction claims referred to above, and other causes of action which office holders obtain locus to bring on their appointment. Wider interstitial decision-making is, therefore, relevant to claims brought by office holders or at their direction. When office-holders are bringing claims, however, the policy considerations, particularly when appellant courts are fixed with cases, are very different.

13. The Courts recognise that the claims are brought for the benefit of creditors of insolvent estates. In *Jetivia SA & Anor v Bilta (UK) Ltd & Ors* [2015] UKSC 23 the Supreme Court refused to allow an illegality defence to proceed, holding that directors cannot be attributed to the company in the context of a claim against the directors for a breach of their duties. In *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd (Rev 1)* [2019] UKSC 50 the Supreme Court allowed refused an appeal against a substantial Quincecare judgment against the Defendant bank. It refused to accept that the fraud by the controlling mind of the company should be attributed to the company.

Insolvency as a tool to unravel fraud

14. In conclusion it is often said that *"fraud unravels all*[20]." Insolvency proceedings, however, tug on the threads of fraud and start the process of unravelling the fraud and the remedies available to the victims. The powers of insolvency practitioners smooth the process of procuring evidence. The Act means that there is often, subject to satisfactory evidence, good prospects of pursuing actions. Fraudsters who lurk in interstitial spaces will often find that public policy favours the office-holder's recovery action.



14 Section 238 and 238 of the Act in the context of corporate insolvency and Section 339 and 240 of the Act in the context of personal insolvency.

15 Section 214 of the Act.

16 Section 238(3) and 239(3) of the Act in the context of corporate insolvency and 339(2) and 340(2) of the Act in the context of personal insolvency.

17 Section 214(1) of the Act.

18 The key note lecture given at the Insolvency Lawyers Associate Annual Dinner in 2018; https://www.ilauk.com/docs/iladinner_2108pre_dinner_talk_the_role_of_the_courts_inherent_jurisdiction_in_insolvency_litigation.pdf

19 The rule of Law and the Perils of Judicial Discretion (2012) 56 SCLR 135

20 See for example Takhar v Gracefield Developments Ltd & Ors [2019] UKSC 13

THE CROSSOVER BETWEEN FRAUD AND INSOLVENCY IN MY JURISDICTION

Authored by: Jamie McGee - Bedell Cristin

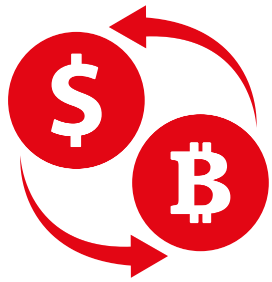
> ***"Whoever commits a fraud is guilty not only of the particular injury to him who he deceives, but of the diminution of that confidence which constitutes not only the ease but the existence of society."***
>
> **- Samuel Johnson**

Fraud and insolvency are inextricably linked and have been since the introduction of the company, becoming particularly visible in times of financial crisis.

The archetype is all too familiar to all of those who practice in the insolvency arena: a fraud is committed, which ultimately leads to the financial status of a company being compromised; the company comes under scrutiny from regulators, investors, shareholders or other stakeholders; debts are ultimately not satisfied; an insolvency appointee takes control of the company.

As the global investment framework evolves, the legislature and the judiciary need to also evolve to deal with the cross-border nature of fraud and fraud involving new types of assets such as virtual assets if the remedies available to insolvency appointees are to be successful.

The Cayman Islands ("**Cayman**"), as a centre for international investment structures and whose products are often used for novel structures and purposes, is always working to address the needs of insolvency appointees in a fraud context. Old tools are dusted off and applied to new situations to provide certainty for the users. Lacunas in jurisprudence are resolved, taking account of jurisdictional needs. New laws are created to cover new remedies in new situations and new asset classes. The Cayman legislature, regulators, law enforcement agencies, judiciary and financial industry constantly focus on ensuring that the victims of fraud have the best chance possible of recovering the ill-gotten gains from a fraudster. This essay addresses just 3 of the ever-evolving tools which Cayman insolvency appointees dealing with fraud have available to them.



Virtual Assets are Property

Crucial to tackling fraud is the ability to recover assets fraudulently taken from the owner. Any insolvency appointee has statutory rights that work alongside civil remedies to enable them to hunt down and claim property belonging to the estate over which they are appointed. Essential to being able to do so is to show that what has been taken is property that belongs to the estate.

There have been myriad well publicised crypto-currency frauds recently and blockchain data firm, Chainanalysis, asserts there was US$14 billion worth of cryptocurrency subject to fraud in 2021. With fraud on this scale inevitably insolvency will result. In the context of cryptocurrency, non-fungible tokens and other virtual assets establishing that what has been the subject of fraud is property has had its challenges. Various jurisdictions such as England, BVI and Singapore have answered the question in case law for crypto currency but arguably that does not provide the certainty that ideally an insolvency appointee needs when embarking on a trace and recover exercise for a digital asset yet to be the subject of a case.

In the Cayman the Virtual Asset (Service Providers) Act 2020 ("**VASP Act**") was passed in May 2020 and introduced a regulatory and licensing regime for the conduct of virtual assets business and those providing services for such business.

The VASP Act gives a definition as follows:

"virtual asset" means a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes but does not include a digital representation of fiat currencies".

At the core of the definition are the aspects of transferability and exchangeability, intending to capture activities rather than asset types.

Whilst the definition in the VASP Act does not go so far as to determine that virtual assets are property or determine ownership the existence of a definition of what is a virtual asset under Cayman law, it does enable an insolvency appointee to at least provide a court with a clear indication that digital representations of value in the estate are virtual assets and that Cayman law allows for their identification, trading and transfer, which are hallmarks of something that is property.

Whether virtual assets are property has not yet come before the Cayman courts but much can be gleaned from the judicial development of the matter in England and Wales, which is accepted as persuasive authority in the Cayman courts. The English High Court determined in *AA v Persons Unknown* [2019] EWCH 3556 that a crypto asset was capable of being classed as property, and, therefore, capable of being the subject of an interim remedy such as a Mareva injunction. This view was subsequently reinforced by *ION Science v Persons Unknown* (unreported, 21 December 2020).

On the basis of the principles from the cases from England and Wales, which establish the hallmarks of what is property and have been followed in Singapore and BVI, I consider that the VASP law definition of virtual assets will enable a Cayman Court to find the necessary hallmarks exist and virtual assets are property so that any digital representation of value will be able to be considered as property and traced and recovered as such.

Aiding Foreign Insolvency Appointees

Fraudsters do not respect borders; in fact they seek to exploit the existence of borders and the potential barriers they create for law enforcement agencies and insolvency appointees to chase stolen assets. In Cayman the legislature has recognized the need to limit fraudsters ability to hide behind jurisdictional barriers.

Section 11A of the Grand Court Act (2015 Revision) ("**11A**") permits the Court to grant interim relief in relation to proceedings which have been or are to be commenced in a court outside of Cayman and which are capable of giving rise to a judgment which may be enforced in Cayman under any Act or at common law.

The ability to grant such interim relief is a vital weapon in any circumstances involving fraud, and is exceptionally useful to foreign insolvency appointees in the circumstances where time is of the essence. Often action is needed before all of the books and records have been found or fully digested or where the full circumstances surrounding the fraud haven't come to light. Even without enough to fully set out and commence a claim in court these remedies are available and may be what enables the insolvency appointee to access the information needed to launch the claim. The early access also avoids the ready to be commenced claim from coming to the attention of the fraudster before everything has been done to try to prevent the assets which are being chased being moved by the fraudster as soon as it is realized their location is known.

The tools available under 11A are: Mareva Order (otherwise known as a Worldwide Freezing Order, which would otherwise prevent a respondent from dealing with the relevant assets); Norwich Pharmacal Order (or Disclosure Order which would allow the applicant to seek information from third parties in relation to the movement of particular assets) and Banker's Trust Order (usually made against banks, exchanges or other entities which either hold the misappropriated or stolen assets or through whom such assets have passed).

The judiciary has also recently confirmed that in Cayman the Norwich Pharmacal Order is available to aid foreign proceedings and not excluded by statutes dealing with obtaining evidence for foreign proceedings thereby departing from cases from England and Wales but concurring with the BVI Judicial view (see *Essar Global Fund & Essar Capital Fund v ArcelorMittal USA LLC (unreported, CICA (Civil) Appeal 15 of 2019)*.

Laws Governing Debts

Given the notable surge of recent cases involving the Gibbs rule (explained below) I felt a look at the key principles was germane to the subject of this essay as the venerable Gibbs rule is being questioned as to whether it is fit for purpose after 130 years.

Fraudsters know well the barriers that arise when a victim of fraud has to pursue the assets through multiple legal systems. An insolvency appointee dealing with a fraudster needs to be confident that any arguments over discharge of debts which can be a feature of fraud (e.g. it is argued that the ill-gotten gains legally belong to the fraudster as they were to satisfy a debt) will be determined under an easily ascertainable law. In Cayman, the Gibbs rule applies so the insolvency appointee can be confident that a Cayman law debt can only be analysed under Cayman law.

The Gibbs rule is named from the case in which it was formulated: *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399) and states that, the proper law of a debt governs how it may be extinguished so that English law debt may only be discharged under English law.

In a recent ruling in the English Court of Appeal (*Bakhshiyeva v Sberbank of Russia* [2018] EWCA Civ 2802) the Gibbs rule has come under some criticism. The case involved the OJSC International Bank of Azerbaijan (IBA) which was going through a voluntary restructuring in Azerbaijan, however some of the creditors' debts were English law governed and those creditors had neither participated in the restructuring nor submitted to the jurisdiction of the Azerbaijani court. Pursuant to the Gibbs rule the claims governed by English law could not be discharged or altered by the Azerbaijani proceedings. The Court cited the Supreme Court's ruling in *Rubin v Eurofinance SA* [2012] UKSC 46 which held that the principle of universalism could not be used to justify the disregard of English law to assist a foreign insolvency process.

Although, courts have recently upheld the Gibbs rule in England and Hong Kong it was recently rejected in Singapore in *Pacific Andes Resource Development* ([2016] SGHC 210).

The difficult thing about the Gibbs rule is that it is helpful for the insolvency appointee chasing a fraudster who has set up contracts and loans as a way to seek to justify the appropriation of assets but less helpful to the insolvency appointee trying to deal with an insolvency involving creditors from many jurisdictions whose claims are sought to be compromised.

Cayman, Insolvency and Fraud

As many will know ever since the making of the film 'the Firm' in Cayman, Hollywood has continued to portray Cayman as the place the bad guys send the money. If that were actually true then the victims of fraud would have a pretty easy time getting their money back! Having said that, Cayman, as an important part of the global financial system, is a jurisdiction that will, alongside all the other major financial hubs, see its share of entities and transactions that are connected to fraud. The highly sophisticated and ever developing insolvency resources and tools, as well as tools available to foreign insolvency appointees, in Cayman make the jurisdiction a leader in the fight against international fraudsters.

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THE POWERS OF THE FOREIGN BANKRUPT COMPANY AND THE FOREIGN BANKRUPTCY ADMINISTRATOR TO ACT BEFORE THE SWISS AUTHORITIES IN CASE OF FRAUD

Authored by: Natalia Hidalgo - Monfrini Bitton Klein

When a foreign company is defrauded and goes bankrupt, several connections with Switzerland may exist. If the company has been the victim of criminal acts committed by its corporate organs, it is possible that these organs have used accounts in Switzerland to divert funds or to launder them. It is also possible that the company itself has assets in Swiss accounts that will have to be recovered in the foreign bankruptcy proceedings.

In cross-border fraud context, several proceedings may therefore be necessary in Switzerland, not only to establish the liability of legal entities and individuals, but above all to recover funds to reduce the damage caused. This will involve, for example, civil and criminal proceedings against Swiss banks and their employees who participated in the fraud or in the laundering of its proceeds.

In principle, the recognition of foreign bankruptcy decisions leads to the initiation of auxiliary bankruptcy proceedings to liquidate the bankrupt's assets located in Switzerland by a local administrator (the Swiss "ancillary bankruptcy" or mini-bankruptcy).

However, since 2019, at the request of the foreign bankruptcy administrator and in the absence of Swiss preferred creditors, the Swiss competent court can waive the ancillary bankruptcy proceedings, and authorize the foreign bankruptcy administrator to directly bring proceedings in Switzerland.

Knowing the standing of the parties potentially involved (foreign bankrupt company, foreign bankruptcy administrator, ancillary bankruptcy administrator) is particularly important, as Swiss criminal law restricts the actions of the foreign bankruptcy administration in Switzerland.

Indeed, under Article 271 para. 1 of the Swiss Penal Code (PC) it is a crime for agents of a foreign State to carry out acts on Swiss territory which under Swiss law are the prerogatives of Swiss authorities.

Acts of foreign administrators in Switzerland may therefore constitute a criminal offense under Article 271 PC.

I. Action against a debtor in the civil courts

When a foreign bankruptcy administrator intends to act in Switzerland against a debtor to recover assets located in Switzerland, the question arises as to which of the bankrupt company, the foreign bankruptcy administrator or the ancillary bankruptcy administrator can take action before the civil courts. This problem must be solved notably when the bankrupt company wants to act against a Swiss bank for its potential liability in the fraud or the laundering of its proceeds.

First, it should be noted that the principle of territoriality applies in Swiss bankruptcy law. Accordingly, foreign bankruptcy decisions have generally no direct effect on Swiss territory.

Whether the foreign bankruptcy administrator can act and seize assets on behalf of the foreign bankruptcy estate in Switzerland is then determined according to Swiss private international law, i.e. the Federal Private International Law Act (PILA).

Prior to recognition, the foreign bankruptcy administrator would only be entitled to request recognition of the foreign bankruptcy decision and protective measures. In this context, case law is clear that the foreign bankruptcy administrator is not entitled to bring an action against a Swiss debtor or to file a claim in the bankruptcy of a Swiss debtor. The reason is that the acts mentioned would circumvent the system designed by the PILA, which aims notably to give preference to creditors domiciled in Switzerland.

However, even when the foreign bankruptcy decision is recognized in Switzerland, the PILA and the case law of the Swiss Federal Supreme Court also strongly limit the scope of action of the foreign bankruptcy administrator in Switzerland.

We can mention the following hypotheses of actions:

- Firstly, the foreign bankruptcy administrator may act in accordance with the powers provided for in the PILA, in particular the avoidance claim provided for in Articles 285–288a und 292 of the Federal Debt Enforcement and Bankruptcy Act (DEBA) (art. 171 PILA).
- Secondly, the foreign bankruptcy administrator has special powers of action in the event of a waiver of ancillary bankruptcy proceedings (art. 174a PILA).
- Thirdly, the foreign bankruptcy administrator can act when it has been assigned the rights of the ancillary bankruptcy estate according to the terms of article 260 LP. Indeed, as soon as the foreign bankruptcy administrator has requested the recognition of the foreign bankruptcy decision and the ancillary bankruptcy is opened, the ancillary bankruptcy administrator has the possibility to pursue the claim for the ancillary bankruptcy estate. If both the ancillary bankruptcy administrator and the creditors waive their right to bring action, the foreign bankruptcy administrator may request the application of article 260 DEBA which will give him the possibility to bring the action against a debtor, such as a Swiss bank.
- Fourthly, the foreign bankruptcy administrator can bring an action in Switzerland when the assets in question are not located on Swiss territory. The hypotheses of such an action in Switzerland in the absence of assets located on Swiss territory seem rare, but we can mention an action based on a choice of court.

According to the Swiss Federal Supreme Court, if the foreign bankruptcy administrator were granted the same powers as the ancillary bankruptcy administrator, in particular the power to bring an action directly against a Swiss debtor, the admission of the action would have the effect of taking assets away from the Swiss creditors admitted to schedule of claims of the ancillary bankruptcy, which would be contrary to the purpose of the system established by the PILA.

Therefore, when assets are in Switzerland and the foreign bankruptcy decision has been recognized, the enforcement of a claim can take place through the following channels:

- by the ancillary bankruptcy administrator, who will remit the net proceeds to the foreign banruptcy estate once the foreign schedule of claims has been recognized;
- by the foreign bankruptcy administrator in case of a waiver of the ancillary bankruptcy proceedings;
- by the foreign bankruptcy administrator if he is assigned the claim, the proceeds of which will be remitted to him once the foreign schedule of claims has been recognized.

Thus, Swiss law takes a restrictive approach to the powers of action that a foreign bankrupt administrator may bring to recover assets located in Switzerland through civil proceedings when the foreign company was victim of a fraud. It cannot itself act directly in Switzerland against its debtor, since this competence is in principle exercised by the ancillary bankruptcy administrator. The foreign bankruptcy administrator is drastically limited in its powers of action when it follows the classic path of PILA (recognition of the foreign decision and subsequent opening of ancillary bankruptcy proceedings). The foreign administrator has, however, more proactive options, such as to request the assignment of the claim or the waiver of the ancillary bankruptcy, which give the foreign bankruptcy administrator more room for maneuver and control.

II. Participation of the foreign bankrupt company in criminal proceedings

In addition to civil proceedings, the defrauded company will have an interest in participating in criminal proceedings in Switzerland against third parties who were part of the fraud or the laundering of its proceeds. For example, when criminal proceedings are initiated against a bank employee who took part in the fraud, it will be important for the company to access all the documents gathered by the Public Prosecutor to obtain evidence in support of actions for damages or other actions.

In Switzerland, the status of party to criminal proceedings gives access to various rights, including the right to be heard provided for in Article 107 of the Swiss Code of Penal Procedure (CPP), which includes notably the right to inspect the documents relating to the criminal proceedings, to take part in procedural acts and to submit requests for further evidence to be taken.

According to Article 104 para. 1 CPP, the plaintiff is considered a party to the criminal proceedings and therefore has these procedural rights.

The question of whether the foreign bankrupt company can be considered a plaintiff must be examined in the light of several provisions of the Swiss Code of Penal Procedure.

According to Article 118 para. 1 CPP, a plaintiff is a person suffering harm who expressly declares that they wish to participate in the criminal proceedings as a criminal or civil claimant. Indeed, in the criminal proceedings, the person suffering harm can either request the prosecution and punishment of the person responsible for the offense (criminal complaint) or request compensation for his damage (civil claim), or both (art. 119 al. 1 CPP).

The concept of "person suffering harm" is therefore essential in criminal law since it is a condition to be a plaintiff.

Article 115 para. 1 CPP defines the person suffering harm as a person whose rights have been directly violated by the offense. Therefore, the person who wants to be a plaintiff must prove that the damage suffered is plausible and that there is a link between the damage and the offense. When a property-related offense is committed against a company, only the latter suffers damage and can claim to be the injured party. This is not the case for its shareholders or beneficial owners.

Therefore, when the company goes bankrupt, it may be granted plaintiff's status if it can prove that its rights have been directly violated by the offense under investigation.

In a decision rendered in 2017, the Geneva Court of Justice examined the capacity to appeal of a bankrupt Lithuanian bank whose status as plaintiff was disputed.

First of all, the offenses denounced by the foreign bankrupt company - unfair management and money laundering - could be invoked by it, since it had been directly injured by those alleged acts.

In the case at hand, the bankruptcy administrator of the Lithuanian company had obtained in Switzerland the recognition of the Lithuanian bankruptcy decision and the opening of an ancillary bankruptcy, administered by the Swiss Financial Market Supervisory Authority. The latter had assigned, according to article 260 DEBA, to the foreign bankruptcy administrator, the rights that the estate of the ancillary bankruptcy had renounced to enforce.

According to the Court of Justice, despite the assignment, the foreign bankrupt company was still a "person suffering harm" within the meaning of Article 115 CPP and a plaintiff according to Article 118 CPP. It therefore remained a party to the proceedings and had a right to support the prosecution and to appeal against the order to abandon the proceedings issued by the Public Prosecutor.

Swiss law therefore adopts a more flexible approach in criminal proceedings than in civil proceedings, as it directly allows the defrauded foreign company to be a plaintiff against the third party who committed the offense.

The foreign company that goes bankrupt can therefore act on its own without the need to obtain the approval or the assignment of rights by the ancillary bankruptcy. In this way, it acquires procedural rights that could prove advantageous, particularly when there are parallel proceedings in Switzerland that require the provision of evidence.

It should be pointed out that - even if the foreign bankrupt company is a plaintiff in the criminal proceedings - the ability to obtain civil compensation for the damage caused by the offense (whether before the criminal court or in a separate civil action) remains with the ancillary bankruptcy administrator or the foreign bankruptcy administrator in case of assignment or waiver of the ancillary bankruptcy.

CONCLUSION

In conclusion, the bankruptcy of a foreign company with links to Switzerland is likely to trigger numerous administrative, civil or criminal proceedings.

Swiss law offers several legal avenues to obtain compensation in case of fraud.

The powers of the parties entitled to intervene in these proceedings - in particular the foreign company or the foreign bankruptcy administrator - will depend on the type of proceedings and the specific circumstances of each situation. Coordination between the various proceedings and the many actors involved, as well as the establishment of a recovery strategy, is therefore crucial to increase the chances of recovering assets.

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HOME IS WHERE THE FRAUD IS:

THE CROSSOVER BETWEEN FRAUD AND INSOLVENCY IN UKRAINE

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As in other FSU countries, an average Ukrainian experience with post-capitalism and wealth accumulation has never been homogeneous. A success story for one business often turning to the failure saga for another – that's indeed a regular description of what the Ukrainian workout, reorganization and insolvency look like.

The absolute majority of the Ukrainian formal insolvency cases were and are fraud related. There are little to none examples of formerly successful businesses failing off because of some externalia's influence, be it local currency volatility or supply\demand shocks.

An average Ukrainian insolvency in broad brush strokes is an attempt of getting the max from creditors in either supplies or financing and getting away with it.

This particularly refers to the Ukrainian agricultural producers and resellers – the market where high default risks are often sacrificed to the highest profits.

Should such attempt be successful for the debtor's owners or not is, as a rule, on the creditors' side. And that's the very occasion when a tandem of fraud action and insolvency might create an extremely powerful leverage. Such leverage, if used properly, will surely give creditors either the debtor being all dressed up and ready to liaise the repayment on the creditors' terms – or a package of repayment means and the higher collection ratio.

Let's imagine (and rather recall for the author himself) a Ukrainian company leading the way in the national seed and agrichemistry distribution for almost a decade. With all the world's leading producers as regular suppliers the company never used any external financing – well, why do that if because of the suppliers' corporate policies and the strong competition you'd constantly been receiving both deliveries sufficient to keep your own wholesale network rolling and the generous deferment terms?

For the market itself the company's first promissory note defaults came as a big surprise – but the subsequent formal insolvency was surely not. With over USD 35 mln of matured claims and only USD 0,3 mln in assets the company was seemingly predestined to quickly pass the court liquidation with the extremely low distributions.

Well, just seemingly – as two of five key creditors managed to initiate a fraud, wrongful trade and embezzlement criminal action against the debtor's former owners and management.

First came an access to the debtor's full set of pre-insolvency financial and accounting documents and the following access to 12000-page bank records. Albeit formally creditors are eligible to gain such access from the insolvency process, it would have become a mission-impossible task with an uncooperative (and presumably debtor-funded) insolvency trustees (which wasn't the case at all).

Secondly came forensic and corporate audit results showing formal owners change and more than GBP 16 mln in cash (just from one of five bank accounts) drained to the UK-incorporated opaque companies. Purely Slavic surnames in the Companies House records of these opaque companies just gave the whole picture some additional charm.

Guess that followed, aren't you? The management was claimed to be jointly liable before the creditors, the drained funds requested for claw back and prospects for the owners to be taken into custody. Quite enough for the owners to recall of their company creditors – and of a newly- incorporated company blossoming with the wholesale network of its predecessor and being leveraged enough to cover an out-of-court settlement.

Was this one a fictional case? How many would-have-beens or could-have-beens the real story has?

Let's keep this shrouded in mystery for now and better focus on those most meaningful parts.

The pre-trial criminal investigation provided the creditors with two potential leverages – financial, accounting and bank records access plus personal restrictive measures against the debtor's de facto owners and management. The insolvency process gave the remaining part of claw back action (widely used with the country's 2019 Insolvency Code) and personal liability (supported by the Ukrainian Supreme Court intensively from 2018).

It's quite hard to crystal-ball whether the named criminal case would finally end in a verdict. The more important is that the criminal case was pursued by just two of five creditors' efforts – and it's these creditors who gained the X claim conversion while others have still been waiting for something from the formal insolvency process itself.

The most important part is that from a creditor's perspective the fraud action should never become a Kantian Ding an Sich.

Just a tool in the skillful hands combining the fraud's action promptness and radicalism with the classical workout instruments. In the end all the true motives, the debtor's very reason for distress and the depth of its management & owners fraud might still remain in the shadows – but a client-favored legit outcome will surely not.

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