SELADORE LEGAL

SELADORE LEGAL

INTERNATIONAL FRAUD AND ASSET TRACING INSIGHTS

In this bulletin, we reflect on selected issues which will be of interest to clients and civil fraud practitioners to highlight matters which might be overlooked and to consider the implications of recent Court rulings. In this first issue, we focus on:

1. Bankruptcy and the subsisting rights of victims of fraud;
2. Norwich Pharmacal Orders and the use of independent IT experts;
3. Collateral use of documents in fraud cases; and,
4. Recent developments in the BVI to legislate for interim relief in support of foreign proceedings.

1. Bankruptcy: The Subsisting Rights of Victims of Fraud

By virtue of section 281(1) of the Insolvency Act 1986, when an individual is discharged from bankruptcy, they are also released from the majority of their unsatisfied bankruptcy debts.

This means that, generally, a creditor holding a bankruptcy debt against an individual will lose the entire benefit of any debt which is unproven or not fully satisfied, and all of the associated rights and remedies, upon the discharge of the bankruptcy.

Section 281(3) of the Insolvency Act

Section 281(3) of the Insolvency Act states that "*discharge does not release the bankrupt from any bankruptcy debt which he incurred in respect of, or forbearance in respect of which was secured by means of, any fraud or fraudulent breach of trust to which he was a party*".

However, not all debts are automatically released upon an individual's discharge from bankruptcy. In specific circumstances, an individual can remain liable to certain creditors after discharge of the bankruptcy. In particular, by operation of section 281(3) of the Insolvency Act, any bankruptcy debts arising out of fraud or a fraudulent breach of trust will continue to subsist even after the individual's discharge from bankruptcy.

As a result of this, creditors whose claims are based on fraudulent behaviour are placed in a better position than other unsecured creditors, as their claims, and associated rights and remedies, will survive the bankruptcy.

The Meaning of Fraud: Recent Case Law

The meaning of "*fraud*" and "*fraudulent breach of trust*" for these purposes is wider than one might otherwise assume.

SELADORE LEGAL

In the recent case of *Jones & Pyle Developments Limited v John Craig Rymell*, the Court considered whether a judgment debt survived the defendant's discharge from bankruptcy. There, the court confirmed the essential ingredient for a debt to have been incurred in respect of "*fraud*" or "*fraudulent breach of* trust" for the purposes of section 281(3) of the Insolvency Act is deliberate (or reckless) conduct involving an element of dishonesty. Conduct which may be regarded as unconscionable but does not necessarily involve actual dishonesty would not be sufficient.

However, as the court made clear in *Kekhman [2018] EWHC 791 (Comm)*, this means that the concept of fraud for these purposes is not limited to debts arising as a result of a pure deceit claim in tort. It can extend to cover any debt arising as a result of deliberate, dishonest conduct.

As a result, it would, for example, be possible for contractual claims, as well as claims for breach of fiduciary duty, to survive bankruptcy if the creditor can point to actual dishonesty on the part of the debtor as a feature of the particular breach in question.

S.281(3) therefore has the potential to be an extremely useful tool for victims of dishonest conduct where the debtor has either deliberately chosen to put himself into a position where bankruptcy arises as a result of a claim against him for dishonest conduct, or otherwise where a defendant becomes bankrupt more generally but has in the meantime incurred a liability based on dishonest conduct. In those circumstances, a judgment creditor can wait for the bankruptcy to be discharged and continue to seek enforcement.

2. Norwich Pharmacal Orders and the Use of IT Experts

A Norwich Pharmacal order is a court order which compels a respondent mixed up in wrongdoing to disclose to the applicant relevant documents or information to enable the applicant to seek redress in respect of the wrongdoing.

The Test for Obtaining a Norwich Pharmacal Order

The test for obtaining a Norwich Pharmacal order was recently confirmed in *Collier & Ors v Bennett [2020] EWHC 1884 (QB)*:

- There must be a good arguable case that a form of legally recognised wrongdoing has been committed (the '**Arguable Wrong Condition**');
- The respondent must be mixed up in the wrong so as to have facilitated the wrongdoing (the '**Mixed Up In Condition**');
- The respondent must be able, or likely to be able, to provide the documents or information necessary to enable the ultimate wrongdoer to be pursued (the '**Possession Condition**'); and,
- Requiring disclosure from the respondent must be appropriate and proportionate in all the circumstances of the case, bearing in mind the exceptional but flexible nature of the jurisdiction (the '**Overall Justice Condition**').

Norwich Pharmacal orders are frequently used in cases of fraud, as they allow a victim of fraud to obtain disclosure from a third party which can, for example, help them identify the ultimate wrongdoer or track where funds have been diverted by a fraudster.

In most Norwich Pharmacal cases, the Respondent is either entirely innocent of any wrongdoing itself and/or neutral as to the question of whether and to what extent information should be disclosed subject to having such disclosure legitimised by a court order. However, in fraud cases, there will be circumstances where the "innocent" third party has a motivation to make compliance with the order difficult or protracted. It is important to understand that, whilst the courts are sympathetic to third parties who are the subject of Norwich Pharmacal orders, proper compliance will be required and, in particular, excuses based on technological shortcomings will not be tolerated.

Failure to Comply with a Norwich Pharmacal Order: the Involvement of Independent Experts

The case of *Patel v Unite [2012] All ER (D) 155* provides a particularly interesting precedent as to the options available where a respondent fails to comply with a Norwich Pharmacal order.

This case involved an airline pilot, Mr Patel, who had been the victim of threats, harassment and defamatory allegations by anonymous posts on the British Airlines Stewards and Stewardesses Association (BASSA) online forum. This forum was controlled by the trade union, Unite.

Mr Patel applied for a Norwich Pharmacal order requiring Unite to carry out a reasonable search for information that would allow him to identify the authors of the anonymous posts, against whom he argued he had actionable libel claims.

However, Unite failed to fully comply with this order, saying that it could not provide the details of the authors because the forum had already been deleted. Mr Patel was not satisfied with this, and made a further application for a Norwich Pharmacal order, arguing that Unite lacked the requisite IT knowledge and expertise to comply with the order. He therefore argued that an independent expert should be appointed to make an image of Unite's database and to create a report containing the requested information.

In its judgment, the High Court acknowledged that the order sought was particularly intrusive. However, it found that the respondents' evidence of its attempts to comply with the original order was in "*an unsatisfactory state*" and held that the Court must be allowed to make further orders to assist the respondent to comply if there is reason to believe that a previous Norwich Pharmacal order has been frustrated due to a lack of technical understanding. It therefore granted the order sought, ruling that an independent expert be appointed to make an image of the database. The Court emphasised that this form of electronic disclosure must be both necessary and proportionate in the circumstances (which it was in this case).

This case represented the first time that this form of follow-up order for disclosure had been granted. It is therefore a good example of the Court relying on the flexibility provided by the equitable origins of the Norwich Pharmacal jurisdiction to do justice in the case.

The approach adopted in *Unite* has since been followed the Court on a number of occasions, including in the context of document preservation and delivery up orders in respect of electronic information under CPR 25 (see, for example, *Wild Brain Family International Ltd v Robson* [2018] EWHC 3163 (Ch) in which the Court adopted the "*necessary and proportionate*" test used in *Unite*).

SELADORE LEGAL

3. Collateral Use of Documents in Fraud Cases

Under CPR 31.22, where a document is disclosed during the course of litigation, the recipient may only use it for the purpose of those litigation proceedings and not for any other collateral purpose.

The rationale behind the collateral purpose rule was summarised in the case of *Tchenguiz v Serious Fraud Office [2014] EWCA Civ 1409* where the Court said that the obligation to give disclosure is an invasion of a litigant's right to privacy and confidentiality, which is only justified because there is a public interest in ensuring the relevant evidence is provided for litigation. This therefore means that the use of those documents should be confined to the litigation for which the documents were disclosed. The Court also observed that the collateral purpose rule promotes compliance with the parties' disclosure obligations.

However, in certain circumstances, a party may need to rely on a document obtained in litigation for a collateral purpose. For example, where that party has been a victim of fraud, it may need to rely on documents disclosed in English litigation proceedings for the purposes of tracing and securing the fraudster's assets in other jurisdictions.

In such circumstances (assuming the document has not already been put into the public domain by being referred to at a public hearing), a party can apply for permission to use documents outside the litigation in which they were disclosed under CPR 31.22(1)(b).

Applying for permission: CPR 31.22(1)(b)

While the court has a discretion as to when to grant permission under CPR 31.22(1)(b) and any decision in respect of collateral use will likely be highly fact sensitive, the Courts use the following guidance in reaching a decision on whether to grant permission:

1. **Special circumstances** - there must be special circumstances which constitute cogent and persuasive reasons for permitting the collateral use of the disclosed documents (see *Tchenguiz* and *Offshore v Barclays Bank PLC [2020] EWHC 3125)*;

2. **Public policy considerations** – the Court must strike a balance between the right to privacy and confidentiality, and the public policy interest of discovering the truth (*Tchenguiz)*. In *Marlwood Commercial Inc v Kozeny and ors [2005] 1 WLR 104* the Court stated that *"the public interest in the investigation or prosecution of a specific offence or complex fraud should take precedence over the merely general concern of the Courts to control the collateral use of compulsorily disclosed documents"*. In *ACL Netherlands BV and ors v Lynch [2019] EWHC 249 (Ch)* the Court again confirmed that one factor which could outweigh the preservation of confidentiality was the investigation and prosecution of fraud, and in cases of cross-border fraud, the importance of mutual international assistance;

3. **Necessity** – in *ACL Netherlands BV v Lynch* the Court also took into account the question of whether the disclosure could be said to be a present and immediate necessity (and ruled in that instance that the applicant had not established sufficient necessity or urgency for the disclosure of the documents); and,

4. **Prejudice to the party giving disclosure** – the Court will also take into account any potential injustice that could be faced by the disclosing party as a result of the proposed collateral use.

These factors were considered recently in the case of *IFT SAL Offshore v Barclays Bank PLC [2020] EWHC 3125*. In that case, a victim of fraud obtained a Norwich Pharmacal order against a bank into which fraudsters had diverted money. The Norwich Pharmacal order was subject to an undertaking that the documents obtained would not be used to bring proceedings against the bank on the basis that the bank had been on notice of its customer's fraudulent activity.

However, the applicant, having carried out a review of the documents, later sought the Court's permission to use the documents for the purpose of bringing proceedings against the bank.

The Court considered that the principles applicable to applications for permission for collateral use of disclosed documents should also be applicable to the question of whether the undertaking should be discharged in this case.

The applicant argued that the use of the documents was justified by the public interest in the fair resolution of civil proceedings, as well as the public interest in the prevention and detection of fraud.

The respondent bank, on the other hand, argued that allowing such an application would set a precedent that if a Norwich Pharmacal application was not successful in the pursuit of a fraudster, then the documents obtained could instead be used against the bank, thereby encouraging speculative claims to be brought against banks by victims of fraud.

However, the Court was not persuaded by the respondent's arguments, stating that the best way to deal with any such speculative claims would be to seek a strike out or to apply for summary judgment. The application was therefore allowed and permission was granted to the victim of the fraud.

This case serves as a reminder that the Court may well be prepared to flex the collateral purpose rule to assist victims of fraud by granting permission for the use of disclosed documents to pursue claims in other jurisdictions and against other defendants.

4. Recent Developments in the BVI to Legislate for Interim Relief in Support of Foreign Proceedings

Earlier this year, section 24A of the Eastern Caribbean Supreme Court (Virgin Islands) Act (the "Act") was enacted by the BVI House of Assembly, giving the BVI Court the statutory jurisdiction to grant interim relief (such as granting freezing orders) in support of foreign proceedings.

This came about as a result of the recent decision in *Broad Idea International Limited v Convoy Collateral Limited BVICMAP 2019/0026*, in which the long-standing rule established in *Black Swan Investment ISA v Harvest View Limited et al BVIHCV 2009/0399* was overruled.

SELADORE LEGAL

Key Contacts

Simon Bushell
Senior Partner
+44 (0) 7785 254891
Email

Gareth Keillor
Partner
+44 (0) 7716 642447
Email

Kevin Kilgour
Partner
+44 (0) 7716 642444
Email

The rule in *Black Swan* had allowed the BVI Court to grant relief in support of foreign proceedings by allowing it to grant injunctions against a party within the BVI in support of claims overseas. This was therefore a key mechanism for the prevention of fraud at an international level, making the BVI Court a key player in the prevention of cross-border fraud.

However, the decision of the Court of Appeal in *Broad Idea* overruled the established precedent set in *Black Swan*, ruling that interim relief against a BVI entity could not be sought unless that entity was party to substantive proceedings in the BVI or elsewhere. The Chief Justice commented that the BVI legislature was the only body which could grant the BVI Court with the jurisdiction which had been established in *Black Swan*.

Following this decision, the BVI legal community petitioned for clarification by the BVI legislature, as to whether, and to what extent, the BVI Courts had the power to assist foreign courts. This resulted in the enactment of s.24A of the Act, which establishes a statutory basis for the BVI Court to grant free-standing interim relief in support of foreign proceedings.

In the recent case of *Claimant X v A TVI Company 2021/0037*, the BVI Commercial Court provided guidance on the interpretation of s.24A.

Wallbank J stated that the two-stage approach of the English Courts when applying s.25 of the Civil Jurisdiction and Judgments Act 1982 would be adopted for cases brought under s.24A of the Act. As a result the BVI Court will:

1. first consider whether the facts would warrant the relief sought, if the substantive proceedings had been brought in the BVI; and,
2. if they would, then consider whether the fact that the Court has no jurisdiction other than s.24A of the Act makes it 'inexpedient' to grant the relief.

As a result of the enactment of s.24A the BVI court will now continue to play an instrumental role in granting interim relief in support of foreign proceedings and combatting of cross-border international fraud. No doubt, English law authorities on "inexpediency" such as *Credit Suisse v Cuoghi* [1998] QB 818 and *Morris v Lloyds [2015] EWHC 4161 (QB))* will be relevant as the BVI Court builds its own approach to this issue.

The team at Seladore Legal has worked alongside BVI counsel on numerous matters in the BVI, including in relation to interim relief in support of foreign proceedings.

August 2021