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Disruptive Asset Finance

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Welcome

to the Spring edition of Disruptive Asset Finance

Towards the end of 2021, the well known television broadcaster, Arena Television collapsed into insolvency. Administrators revealed that Arena was suspected of inventing fake assets with around £282 million of loans involving over 50 lenders. According to a report of the administrators, only nine of Arena's fifty-five lenders have verified assets supporting their loans. The administrators' report concluded that much of the money owed to lenders was secured against assets which do not exist.

Immediately prior to the business ceasing to trade, it is reported that an agent had been undertaking an asset verification exercise on behalf of one of Arena's lenders. The agent tried to verify a serial number with the equipment manufacturer who advised that no such serial number existed. The agent then raised this as a concern with the lender. According to the administrator's report, the directors of the business, Yeowart and Hopkinson, then abruptly ceased to trade and then reportedly absconded, leaving the UK. The administrators proceeded to successfully obtain a worldwide freezing injunction and a proprietary injunction against both directors. Investigations are ongoing and arrests are now reported with the Serious Fraud Office and National Crime Agency involved.

The scale of this alleged fraud is massive – The administrator's report says that nine of Arena's lenders have verified assets to support their lending, but the remaining 46 others, owed a total of £182 million, "do not have recourse to any assets" that they believed existed.

In the light of this shock to the asset finance industry, in this edition of Disruptive Asset Finance we take an in depth look at some of the legal help that is at hand when faced with fraud.

John Flint

Fraud: criminal action or civil action?

Fraud takes many forms. When the word is used in everyday language usually it will be used to refer to some form of trickery or deceit creating a benefit to the fraudster.

Within a legal context, what fraud means depends on whether you are referring to a criminal fraud or fraud in civil litigation. Even within the civil law the definition of fraud changes.

In the criminal context, fraud is a criminal offence. This means it can be prosecuted in the criminal courts and may result in a criminal conviction and punishment. A confiscation order may be sought against a convicted defendant ordering it to pay the amount of his benefit from crime. A criminal fraud is based in both statute and the common law. Specific elements need to be proven to a criminal standard (beyond reasonable doubt) before an offence can be made out.

This can be contrasted with fraud in the civil context where there is not a single type of claim that can be bought which is labelled 'fraud'. A person who alleges fraud does not bring a claim for 'fraud'. Fraud in the civil setting describes different activities where there may be a variety of available causes of action. Specific claims that might be bought include fraudulent misrepresentation, deceit, conspiracy, breach of fiduciary duty, breach of trust, dishonest assistance and conversion. This list is not exhaustive and which route is perused will depend on the facts of the case. The potential claims all have different elements that need be proven to the usual civil standard (on the balance of probabilities).

Civil proceedings are usually aimed at recovering compensation for losses suffered by the innocent party. For example, obtaining the repayment of a sum of money, recovering assets, seeking damages or being able to cancel a contract so it is treated as if it never made (known as rescission).

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Fraud: criminal action or civil action? - continued

Given that the criminal and civil routes are very different, which route ought to be taken? The choice is unlikely to be straightforward in any case. Where a party wishes to recover money, bringing a civil claim will be necessary and likely maximise recovery.

A fraud, generally speaking, does not have to be reported to the police and, even if it is, an investigation and/or prosecution will not automatically follow. Criminal investigations can also be slow and the innocent party will lose control of the investigatory process as the law enforcement agencies will determine what steps are taken often without consultation with the victim. The costs of the proceedings will rest with the relevant authority.

In contrast to this, bringing proceedings in the civil jurisdiction will give the innocent party more certainty because it will retain control over the proceedings. The victim will be responsible for the costs of bringing the case (although these may be recoverable from the other party in due course). Civil proceedings and supplementary orders can also be bought quickly. For example, a freezing injunction (see below) can be obtained swiftly– sometimes within the same day. In the criminal court, investigations can be much slower and this can risk the dissipation of assets.

It is important to think carefully, often under pressure, about what action is taken first. Strategy is vital. For instance, if matters are first reported to law enforcement a company may find that its assets are seized, which may then make a civil claim difficult, even if the company is the victim. Further, a law enforcement agency will not be able to act as quickly as a private entity in commencing a full investigation and freezing assets.

Where the matter is reported to the police, a civil claim may still be bought. The two systems can work together and, unless the defendant would face a real risk of serious prejudice which may lead to injustice in the proceedings, investigations and claims can be bought at the same time. Indeed in the Arena Television situation, a two pronged attack appears to have been taken by the company against the directors - The administrators bought civil proceedings on behalf of the company in November 2021 and sought injunctions to try and preserve its assets/money but now the Serious Fraud Office and National Crime Agency are also involved. It is not uncommon for a victim to pursue a civil action to quickly safeguard the misappropriated assets and then report the matter to the relevant criminal enforcement authority.

If a fraud is suspected, it is important to engage solicitors who can offer strategic advice from the outset. Taking the right, carefully thought-out steps, can maximise recovery. Each case is different and needs to be considered individually.

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Who will get the assets? Criminal v civil jurisdictions

In the Arena Television case, the administrators' claim includes a claim against the former directors for breach of fiduciary duty. Corporate directors owe fiduciary duties to their companies.

In the Arena Television case, the administrators bringing the claim have relied upon the general duties specified in ss.171 to 175 of the Companies Act 2006 including the following fiduciary duties: (1) a duty to only exercise powers for the purposes for which they were conferred (s.171); (2) a duty to act in the way considered in good faith would be most likely to promote the success of the company for the benefit of its members as a whole (s.172); and (3) a duty to avoid a situation in which the director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company (s.175). The administrators have frozen the directors' worldwide assets via injunctions. However, it has been reported that the Serious Fraud Office is also investigating and some arrests have been made. If the case were to proceed in the criminal courts, the Crown Prosecution Service (CPS) may seek a confiscation order to prevent any defendant from benefiting from the proceeds of their crime. If that were to occur, who would have priority over the assets?

The issue was considered recently by the *Supreme Court in CPS v Aquila Advisory Ltd [2021] UKSC 49*. In this case, two company directors made a secret profit of £4.55m and civil proceedings were bought against them for breach of fiduciary duty and to establish a constructive trust over the unauthorised profit. The actions of the directors meant that the duo had committed the crime of cheating the public revenue by dishonestly facilitating and inducing others to submit false claims for tax relief. They were prosecuted and jailed and the CPS obtained confiscation orders. The CPS then intervened in the civil proceedings and asserted that the dishonest conduct of the directors was attributable to the company that was bringing the civil claim – this meant the company was not able to claim the secret profits from the directors because in doing so it would be relying on its own illegal conduct. The court also had to decide who was entitled to the assets. Was it the CPS in respect of the confiscation order or the company in the civil claim?

The Supreme Court held that the confiscation orders did not give the CPS any proprietary interest in the former directors' assets, or any form of priority over any other claims to those assets.

It was held that, where civil proceedings are brought by a company against its directors for breach of fiduciary duty, claiming that the sums they acquired as a result of the breach are subject to a constructive trust in the company's favour - principles established in *Bilta (UK) Ltd v Nazir [2015] UKSC 23* prevent the attribution of the dishonesty of those directors to that company. Therefore, the company had not acted illegally, and its claim was not barred by its own conduct. It would not make sense to stop a company obtaining a remedy from a dishonest director by having the director's intentions attributed to the company.

This case illustrates how the CPS were unable to obtain priority over other creditors. However, in Aquilla, the Supreme Court commented that the CPS might have recovered the proceeds if it had used appropriate rights within the Proceeds of Crime Act (although this had not been done). The CPS could have added the company to the inditement and, if convicted, the company could have then been bought within the scope of the confiscation order.

Given these comments, the CPS might, in the future, consider this tactical route on the discovery of criminal wrongdoing by directors. However, inditing a company for the purposes of confiscation, or at all, might amount to an abuse of process. For the time being it remains to be seen what criminal charges will be bought, if any, following the insolvency of Arena Television. At least, for now, assets will remain frozen with the potential to be subsequently available for creditors.

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Preserving and tracing assets

When a victim of fraud wants to seek justice in the civil courts ensuring that the fraudster has assets available against which a judgment sum can be enforced is vital.

As Lord Bingham said: an unenforceable judgment is at best valueless and at worst a source of additional loss. The danger that a fraudster might dissipate assets, rendering a judgment useless, is recognised by the courts and a number of orders are available to help protect a vulnerable claimant. It is reported that Arena Television has obtained a freezing order and a proprietary injunction against the allegedly fraudulent directors. What does this mean, what other protective measures are available and how will these injunctions potentially help Arena Television?

Freezing injunctions

A freezing order is an interim injunction that prevents a respondent from disposing of or dealing with its assets. The order will typically preserve assets until judgment can be obtained or enforced but it does not provide any security over the assets. This means that a freezing order does not provide any priority against other creditors and does not give any ownership over the assets. However, it does stop the respondent dissipating assets and this gives the applicant substantial reassurance that damages will be recovered at the end of the case where the claim is successful.

All types of assets can be frozen, including bank accounts, shares, motor vehicles and land. Orders can be obtained in respect of assets within England and Wales but also worldwide. Usually, the value of the assets frozen will be limited to the value of the claim. However, the respondent will typically be permitted to draw on the frozen assets to meet living expenses and reasonable legal costs or, where the defendant is a corporate body, costs incurred in the ordinary course of business.

A freezing order is commonly sought without notice to the respondent (so they are not aware of the application) and is often made pre-action. It is not surprising that such injunctions have been described as a “nuclear weapon” in litigation.

Proprietary injunctions

These are often sought alongside a regular freezing order and may be granted to specifically preserve the subject of a claim where the applicant has a proprietary or tracing claim. The order freezes assets that the respondent holds but which the applicant believes it is the rightful owner of. An application for such an order must specify the particular property.

The test the court will apply for the grant of a proprietary injunction is less stringent than that applied for a general freezing order. With a regular freezing order an applicant will need to show that there is a risk of dissipation but this is not the case with a proprietary injunction. Further, for a proprietary injunction, an applicant need only show there is a serious issue to be tried (in contrast, for a general freezing order there must be a good arguable case). With this type of order, the respondent is generally required to use its own assets to meet its legal and living expenses or business costs meaning that the asset can be frozen in its entirety. Importantly, unlike a general freezing order, a proprietary injunction will give an applicant priority over the respondent’s creditors in the event of the respondent’s insolvency. Importantly, particularly from a strategic perspective, for both proprietary and freezing injunctions, the court will usually require a respondent to file evidence disclosing details of assets.

The Chabra jurisdiction

Where the respondent appears to have few assets in their own name, has concealed or transferred assets or if third parties hold assets on behalf of the respondent as a nominee then an applicant may wish to use what is known as the Chabra jurisdiction. *TSB Private Bank International v Chabra [1992] 1 WLR 231* established that, in certain circumstances, the courts have jurisdiction to grant freezing orders not just against parties to a case but also third parties. A freezing order may be made against a third party (against whom the claimant has no claim) if there is reason to believe that assets which are seemingly belong to the third party are, in truth, those of the defendant against whom the freezing order has been made. Use of this jurisdiction can also be beneficial where the assets that are held by the respondent in its own name are held in jurisdictions where enforcement may be difficult.

Norwich Pharmacal orders and Bankers Trust orders

If an applicant does not know where assets are held then prior to freezing them they will need to be traced. This can be done by way of a Norwich Pharmacal order (NPO). These orders are most commonly brought for the purpose of obtaining disclosure of the identity of a wrongdoer. However, NPOs have wider application. In a case involving civil fraud, they can be used to trace stolen money and find information about the fraudster to assist the formulation of the claim and applications for freezing orders. An order that a bank give disclosure of a third party’s account information often takes effect as a ‘Bankers Trust’ order. NPOs/Bankers Trust orders are often used in fraud cases as the third party is frequently a bank which has received stolen funds and information is sought about the identity of the fraudster or where funds have been diverted. Alongside such an application, a gagging order is often prudent. This stops the third party telling the wrongdoer about the application so that the applicant has a chance to consider the information and take action prior to the fraudster becoming aware of it.

Other orders

Other orders worthy of consideration include a passport order, a search order and orders for the appointment of a receiver. A passport order is usually to assist the enforcement of some other court order and may be sought in exceptional circumstances, most often in serious fraud cases. A search order allows one party in a dispute to enter another party’s premise to search for, copy, and retain evidence. **More can be read about this type of order here**. Receivers are considered in the article on page 6.

It is very easy to see how such orders can be an essential step to recovery in cases involving fraud but they also can also be very powerful tactically. They often lead to the resolution of the dispute without trial. However, legal advice from an expert is a must because an applicant may have to pay the respondent compensation if it is later determined that the order should not have been granted.

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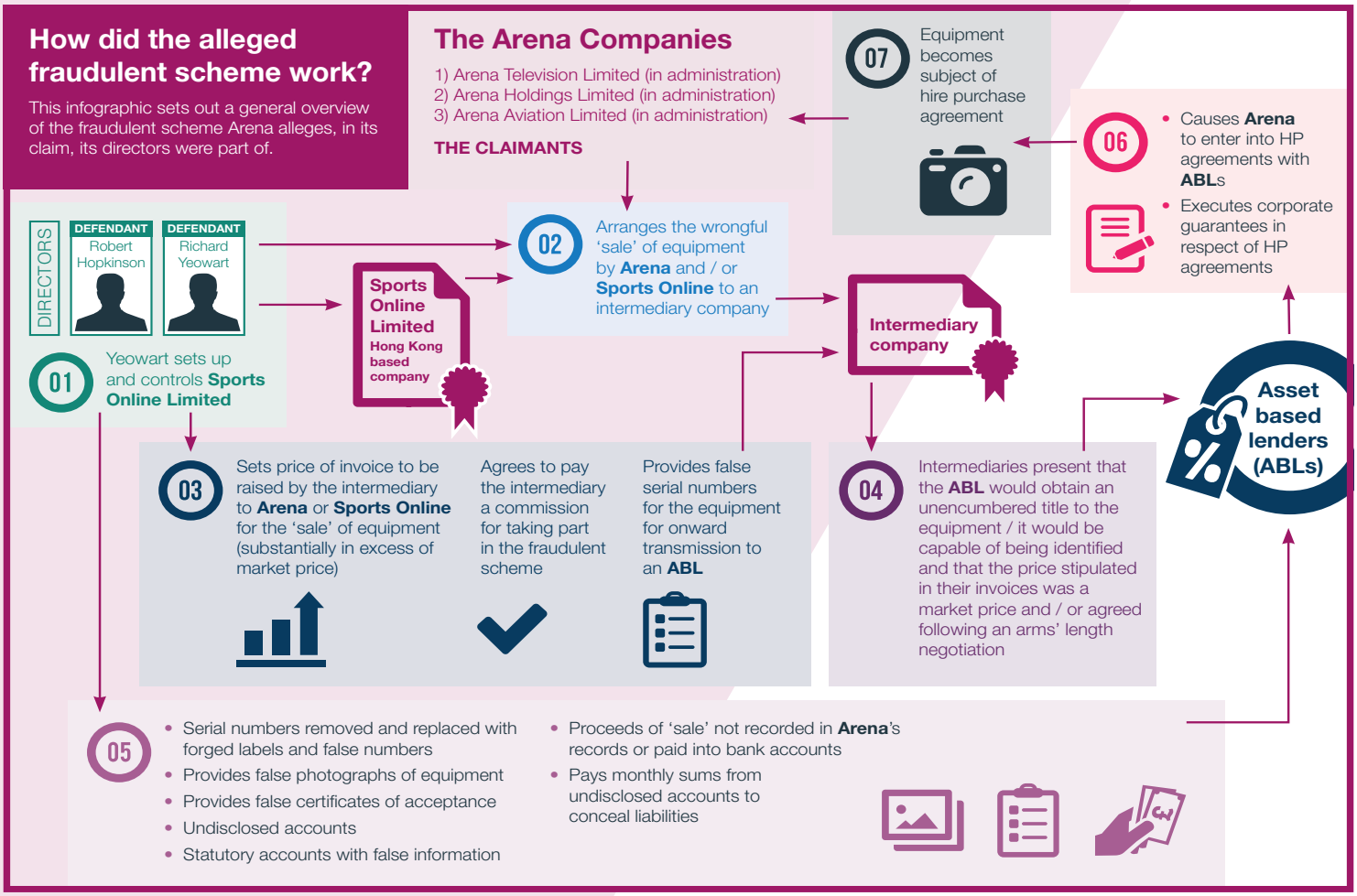
How did the alleged fraudulent scheme work?
This infographic sets out a general overview of the fraudulent scheme Arena alleges, in its claim, its directors were part of.
The Arena Companies
1) Arena Television Limited (in administration)
2) Arena Holdings Limited (in administration)
3) Arena Aviation Limited (in administration)
THE CLAIMANTS
07 Equipment becomes subject of hire purchase agreement
06 Causes Arena to enter into HP agreements with ABLs
Executes corporate guarantees in respect of HP agreements
DIRECTORS
DEFENDANT Robert Hopkinson
DEFENDANT Richard Yeowart
01 Yeowart sets up and controls Sports Online Limited
Sports Online Limited Hong Kong based company
02 Arranges the wrongful 'sale' of equipment by Arena and / or Sports Online to an intermediary company
Intermediary company
Asset based lenders (ABLs)
03 Sets price of invoice to be raised by the intermediary to Arena or Sports Online for the 'sale' of equipment (substantially in excess of market price)
Agrees to pay the intermediary a commission for taking part in the fraudulent scheme
Provides false serial numbers for the equipment for onward transmission to an ABL
04 Intermediaries present that the ABL would obtain an unencumbered title to the equipment / it would be capable of being identified and that the price stipulated in their invoices was a market price and / or agreed following an arms' length negotiation
05
Serial numbers removed and replaced with forged labels and false numbers
Provides false photographs of equipment
Provides false certificates of acceptance
Undisclosed accounts
Statutory accounts with false information
Proceeds of 'sale' not recorded in Arena's records or paid into bank accounts
Pays monthly sums from undisclosed accounts to conceal liabilities

The power of receivership

Court appointed receivers have featured in a number of recent cases involving fraud.

Principally, receivers may be appointed to preserve assets while litigation is ongoing and may also be appointed to assist post-judgment with the enforcement of the judgment debt by way of equitable execution.

An extraordinary case involving a Kazakhstani bank and its former chairman demonstrates how receivership can greatly assist in case of a fraud: the bank claimed its chairman, Mr Ablyazov, had misappropriated billions of dollars of the bank's money *"as if it were his own private source of funds"*. Mr Ablyazov was forced to leave Kazakhstan and relocated to the United Kingdom. Numerous proceedings were brought against him.

A freezing order was obtained against Mr Ablyazov but the bank remained concerned that Mr Ablyazov had been evasive when disclosing his assets and there were several billion US dollars being held in a complex structure that would have made the assets difficult to trace. Rather than hold assets in his own name, a trusted associate appeared to hold shares in a holding company on Mr Ablyazov's behalf and through that controlled the shareholdings in a chain of other off-shore companies - at the bottom of which was an operating business.

The Court agreed that the appointment of a receiver prior to judgment was appropriate[1]. This was an invasive remedy (it displaces the defendant as the person in control of his assets) but here it was justified because the freezing order did not provide the bank with adequate protection against the risk that the assets might be dissipated. Mr Ablyazov could not be trusted. The order made was designed to enable the receivers to assume control of the companies at the top of the respective chains. The order curtailed Mr Ablyazov's freedom to buy, manage and sell his assets in the ordinary course of business as he would only be able to do so with the consent of the receivers or the court.

The case proceeded and in a later judgment Mr Ablyazov was found to be in contempt of court for failing to declare the extent of his assets. The court found he was the beneficial owner of three properties, one of which was on London's so-called billionaire row, which he had not declared. Judgment was subsequently entered against Mr Ablyazov for over $3.6 billion. In seeking to enforce the judgment, the bank successfully applied for the receivers to have the power to sell those three properties.[2] The receivers were already in office and had substantial knowledge of the properties and could proceed faster than a formal charging order. The bank could thereby sidestep the need to make a Part 8 claim for an order for sale.

This epic fraud and subsequent legal battle resulted in Mr Ablyazov being sentenced to 22 months in jail for "serious" and "brazen" contempt of court in trying to hide his assets. However, it is reported that he has since obtained the status of a political refugee in France. Despite the exceptional nature of Mr Ablyazov's case, it demonstrates how a receiver can be appointed both to preserve and release assets to satisfy a judgment debt.

Cases involving fraud often involve assets being held in complex and obscure structures linked to multiple jurisdictions with wholly uncooperative or deceptive defendants. This makes the appointment of a receiver a potentially valuable tool that should be considered in the appropriate case. Despite its origins being hundreds of years old its scope continues to develop to assist the modern litigant.

[1] *JSC BTA Bank v Ablyazov [2010] EWHC 1779 (Comm)*

[2] *JSC BTA Bank v Ablyazov [2013] EWHC 1361 (Comm)*

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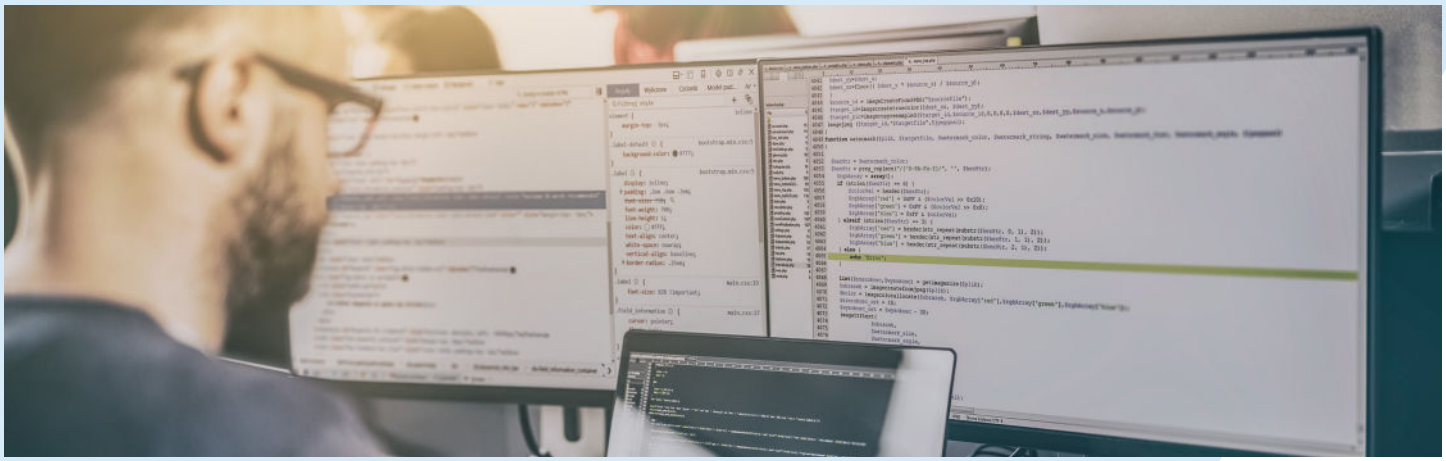

Developments in cryptocurrency and fraud

It has been reported that some of the funds that have been allegedly misappropriated from Arena Television have been placed into a cryptocurrency account. As fraudsters become more sophisticated the law relating to cryptocurrencies, like Bitcoin, Ethereum and Litecoin, is now developing quickly.

What is Cryptocurrency?

Cryptocurrency, is a digital asset that takes the form of tokens or 'coins' located on a decentralised, electronic payment system. Transactions for cryptocurrency are recorded on a public decentralised ledger. The owner has a 'private key' enabling them to deal with their cryptocurrency. A cryptocurrency owner can choose to maintain their own key but many will use a third party cryptocurrency exchange service like Coinbase or Kraken to hold their key and to buy and exchange cryptocurrency.

In England and Wales there is no current legislation that defines how cryptocurrencies are treated in law. However, the court has so far accepted that cryptocurrencies are to be treated as 'property', something recently endorsed by the Master of the Rolls, Sir Geoffrey Vos, in a speech in February 2022.

Enforcement options

Proprietary injunctions, freezing orders and bankers trust orders have all now been granted in cases involving cryptocurrency to assist victims of fraud or theft in preserving and tracing their property to seize it or seek compensatory damages (see page 5). However, questions remain as to whether, and how, parties can enforce judgments against cryptocurrency. A number of commentators have considered that more common methods of enforcing money judgments such as seizing goods, charging orders, third party debt orders and attachment of earnings orders are not available in respect of cryptocurrency. Some have taken the view that the appointment of a receiver, to enforce by way of equitable execution, is the way in which recovery can be made against cryptocurrency (see page 6).

Application of a third party debt order

The High Court has now expanded the body of case law relating to cryptocurrency and has held, in what is understood to be the first decision dealing with the issue, that a third party debt order may be ordered in relation to cryptocurrency. The claimants in the case of *Ion Science Ltd v Persons Unknown* (unreported, 28 January 2022) sought a third-party debt order to enforce their judgment debt against the cryptocurrency exchange Payward Ventures Limited, who run the exchange Kraken. It was held that there was a debt outstanding to the judgment creditor and that there was a debt payable from the third party to the defendants. Therefore, the order could be made.

While this judgment develops the law in this area, it should be noted that third party debt orders are often made when a bank holds funds on behalf of a judgment debtor. Where cryptocurrency is held by an exchange, the relationship is reasonably similar to that of a customer and a bank. Therefore, it is perhaps of little surprise that, in these circumstances, a third-party debt order could be made. While in this case the cryptocurrency was held by a third-party exchange, a creditor may find that the digital key and password are being stored by the defendant personally. Where this is the case, a third party debt order would not be available (there would be no third party). Therefore, enforcing against cryptocurrency in such a situation will be more difficult.

It is also noteworthy that here the defendant was identified (following the earlier disclosure orders) as being a Scottish entity. This meant that the claimants did not have to tackle complex jurisdiction hurdles. Judgment creditors cannot generally use the third party debt order process to attach foreign debts. If the holder of the cryptocurrency was domiciled, for example, in India or the USA the position would be more complicated.

Finally, neither the third party or the judgment debtor in this case appeared to make representations to the court. In the future, having the court undertake a full analysis of the issues, after hearing submissions from all parties, will advance this area of law.

The anonymity long associated with cryptocurrency is being eroded and fraudsters can no longer necessarily hide behind digital assets.

Owen Williams is the co-author of 'Commercial Enforcement' a unique and invaluable guide that advises on the enforcement of high-value money judgments.

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