

The Specialist

Anthony Riem fraud loss litigation

A close look at fraud-busting legal weaponry

Amid widespread losses from the global downturn, a growing number of funds are combing their files and taking legal action in the battle against fraud

The multi-jurisdictional nature of many hedge funds, their investors and the companies they invest in, can make litigation a daunting prospect. In the current financial climate, parties involved with hedge funds are increasingly looking to take legal action to recoup funds lost to negligence, fraud or simply a falling market.

To address this issue, courts in a number of jurisdictions have developed a variety of powers – capable of international enforcement – that enable victims of fraud to recover their losses.

To maximise the prospects of recovering assets, it is important to adopt the appropriate strategy, which requires a specialist recovery team. The team should have a lawyer to formulate and execute the strategy and to ensure compliance with local laws; an investigator to carry out enquiries; a digital forensic expert to investigate and preserve the integrity of electronic evidence; and a forensic accountant to evaluate the extent of the fraud and losses.

The first steps to take, even before issuing a claim, include complying with any obligations, such as reporting the matter to insurers, and adhering to any statutory or regulatory obligations. Then, parties must evaluate the extent of the fraud and the prospects of recovering any losses. This will determine whether it is commercially worthwhile. Inevitably this will involve examining a large amount of electronic docu-

mentation that will determine if the fraud is ongoing and the extent of the losses. It can also identify the fraudster and the location of the stolen assets.

Given that about 80 per cent of fraud cases are committed by or with the assistance of a director/senior manager or employee, it is important that any investigation is carried out without tipping off the fraudster or their accomplice and that the integrity of electronic evidence is preserved. Investigations often need to be carried out in more than one country and it is important to adhere to local laws. Where unusual methods are contemplated, consideration should be given to obtaining the court's sanction beforehand.

In a number of other countries, it may be possible to bring proceedings against the fraudster and other parties who may have assisted in the commission of the fraud, such as recipients of the proceeds. Widening the scope for potential targets increases the prospects of recovering losses.

Some courts are willing to freeze assets held nationally and internationally and by individuals other than the defendant, provided it is shown that they were obtained using the fraudster's assets. At their most basic, the criteria for a freezing order are: a good arguable case, a real risk that the potential defendant will dissipate the assets, a connection with the jurisdiction and full disclosure by the applicant. These are strict requirements because freezing orders are some of the more draconian rulings a court can make. A breach of these orders may put the defendant at risk of criminal prosecution.

Where a claimant wishes to enforce a freezing order abroad, they must also obtain permission from the domestic court to do so. In such circumstances, the court requires compliance with a set of guidelines as set out in *Dadourian Group Inc v Simms*. These guidelines stipulate that for permission to be granted to enforce a worldwide freezing order abroad, it must be just, convenient and not oppressive. Additionally, consideration must be given to the grant of relief to compensate for the costs incurred and the proportionality of the proposed steps to be taken abroad. The penultimate guideline requires that the interests of



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all parties, including those likely to be joined to foreign proceedings must be balanced against each other. Finally, permission will not normally be granted in terms that would enable the applicant to obtain relief in the foreign proceedings that is superior to the relief given by the worldwide freezing order.

US regulators are adopting an increasingly proactive attitude to tackling business irregularity through the courts. The regulator's reach extended even further into Europe in May when the SEC applied to continue a worldwide freezing order against a defendant.

Briefly, the SEC alleged that Glenn Manterfield, a UK citizen and resident, was one of a group of people who created Lydia Capital, a hedge fund, which was US based and registered with the SEC. The SEC alleges that the parties defrauded about 60 investors who had invested approximately \$34m (€27m) in the hedge fund between June 2006 and April 2007. It is alleged that Lydia defrauded investors by: "(1) materially overstating and in some instances completely fabricating the fund's performance; (2) inventing business partners, offices, and investors in an attempt to legitimatise the firm and concealing the truth as to why key vendors and banks ceased relationships with the defendants; (3) lying about Manterfield's significant criminal history, and failing to disclose a February 2007 criminal asset freeze in England; (4) lying about the fund planned to address certain material risks and failing to disclose others; and (5) mis-stating the nature of the fund's assets and its investment process."

As if that were not enough, there are allegations of the misappropriation of millions of dollars of funds, wrongfully withdrawn by Manterfield and another.

The high court ruled that the freezing order should continue until the resolution of the SEC's pending enforcement action in the US.

The use of civil powers by regulators is a welcome development in assisting victims of fraud or financial mismanagement. In the recent past, hedge funds and the financial markets as a whole have enjoyed growing economies, banks that were only too willing to offer leverage and investors who were able to invest using readily available credit.

One of the consequences of the credit crunch has been a re-evaluation of those transactions and the discovery that collateral provided is either non-existent, suffers from undisclosed defects, or was never as valuable as originally represented. There may also be issues as to whether prospectuses and other financial advice provided were misleading.

It is important that those who have lost out are aware that there are effective legal weapons available on an international basis that, when properly utilised, can maximise the prospects of recovering losses that are incurred. ■

KEY FACTS

■ **Claiming back losses from cases of fraud through the courts is a growing trend**
 ■ **For permission to be granted to enforce a freezing order abroad, it must be "just, convenient and not oppressive"**

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