

Risk versus reward: Knowing when to pursue

Jonathan Brown discusses some of the processes involved when encountering fraud or misconduct



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When encountering fraud or misconduct, the thought of commencing open ended civil litigation is enough to bring the majority of insolvency practitioners out in a cold sweat. Uncertainty about the outcome and the potential cost to the estate is usually the first concern, swiftly followed by the justifiable questioning of whether there is in fact a commercial upside.

There's no exact science to weighing up risk versus reward, but a staged, commercially focused approach in these situations gives the greatest chance of recoveries. Such an approach should assess the costs of action, the likelihood of success and, importantly, the pool of assets available from which to obtain returns.

It's fairly obvious that the value of the asset pool should significantly outweigh the likely costs of pursuit. If looking to make recoveries, targeting an individual who has no assets makes little sense. An early assessment of the potential "prize" enables the practitioner and creditors to take an informed view on whether it is commercially beneficial to launch or continue civil action.

Initial information gathering

In the early days of any preliminary asset assessment, the practitioner has access to a variety of information sources, ranging from company records, corporate filings and asset registers, to indirect sources such as internet blogs and media stories. Gathering and filtering this

information is vital in building a picture of the assets which may be available for pursuit and their likely location.

At this stage, anecdotal evidence can be of significant importance. I've lost count of the number of extra marital affairs and scandalous stories shared with me in conversations with employees in the days following an insolvency appointment, but it's the tales of holiday homes, expensive cars and cash transfers to offshore bank accounts that really help.

Communications with third parties will need to be carefully managed to avoid accusations of slander, but it is reasonable for the practitioner to ask creditors to supply details of issues of concern in early communications. Lenders may well hold personal

guarantees, with supporting lists of assets, and others may hold vital background information on the directors or other targets for the claim.

Online information can vary in age and accuracy but internet search engines can throw up valuable details of assets from press stories, court filings, credit reporting, property websites and planning applications. The mix of personal indiscretion and gossip prevalent in social media adds an additional, and sometimes entertaining, dimension to this, but sensible filtration can flag up relationships or background that provide further leads for investigation.

A recent development to aid this process is software that undertakes systematic searching of websites, asset and corporate registers in multiple jurisdictions and languages. Access to

translated media stories originally written in Russian or Urdu, or information taken from South American corporate registries, provides intelligence that would previously have proved difficult or impossible to obtain without a huge investment in man hours.

Access to company records, including email and bank statements, may yield other evidence of assets controlled by the target. It's not uncommon to see email communications relating to the purchase of properties or vehicles, or conversations that flag up transactions requiring further examination. In reality, an asset assessment is an iterative process, with each new piece of information potentially needing the investigator to revisit earlier conclusions as links between individuals and entities become apparent.

The insolvency practitioner is actually in a fairly privileged position when undertaking this type of exercise. Whilst they vary by jurisdiction, officeholders' powers often include the ability to compel individuals and entities to provide documentation or submit for interview. These powers of compulsion are hugely beneficial in gaining access to documents and data that would otherwise be out of reach and can be used to investigate significant leads.

Assessing corporate information

Targets for a claim may well be directors or shareholders of various corporate entities, with some of their interests more obvious than others. Corporate structures can be used to shield assets and it is therefore important

to fully consider and map them in order to identify whether there are other asset bearing entities connected to the target.

There is a common misconception that corporate information is opaque and that gaining access to useful records can be a difficult process, but in an environment of increasing regulation, expectations of transparency mean that this is no longer necessarily the case. Whilst there are still jurisdictions where access to corporate information is limited, even in off-shore locations such as the British Virgin Islands and Jersey, certain data is available.

Corporate filings can tell you who the directors and shareholders of a company are. Where a corporate entity or entities themselves hold the position of shareholder or director in a company, continuing to follow this trail to the end, through the next tier of corporate filings, can lead you to other entities owned or controlled by the target of the claim.

Where financial statements are filed, these may well disclose transactions with related parties, providing an additional set of companies and individuals to scrutinise. SEC filings in particular require a significant level of disclosure and may expose links to offshore entities that would otherwise not be apparent. It would be misleading to suggest that it is always possible to break through the corporate veil,

but by being systematic and persistent, it is often possible to gather significant levels of information on ownership and corporate value to inform interviews or requests for further information using compulsory powers.

Taking insolvency proceedings against the target or entities owned by him may be another option to aid the recovery exercise, as compulsory powers may then be available in order to gain access to the next tier of financial information and, potentially, assets.

The recovery strategy

The output from the initial assessment should be a list of potential assets and their jurisdiction, together with associated estimates of value. Registers of vehicles, property and shares exist in many locations, but there are also comprehensive international registers and databases with details of the ownership and whereabouts of boats, planes and many other categories of asset. These are valuable tools in testing ownership of the assets identified.

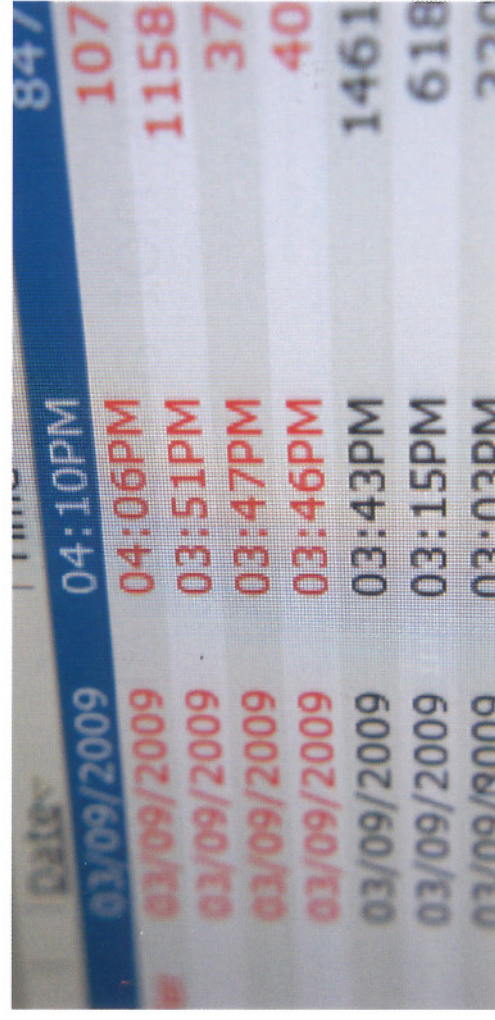
At this stage, a decision needs to be taken as to whether continued pursuit is merited. This decision is likely to be based on a combination of factors, including the estimated value of the assets and the costs and difficulties in taking control of them. There are occasions where creditors will

instruct the practitioner to take recovery action regardless of the costs, to send a message to the marketplace or to punish the individual, but those instances are increasingly rare. It's usually a straight commercial decision.

A decision to proceed may lead to parallel actions in one or multiple jurisdictions, potentially including insolvency proceedings. In cases where there is a risk of asset dissipation, this may include application for a worldwide freezing order over the target with an associated requirement to make full disclosure of assets. Jurisdictions will differ in levels of cooperation and transparency which will impact on the speed and likelihood of success in recovery of assets.

Gaining a summary judgment on one element of a claim can give the practitioner and creditors confidence that there will at least be some returns. These may then be used as a fighting fund to take further actions in relation to larger heads of claim. In other instances, working towards an agreed commercial settlement may well be the best solution, reducing the cost burden of a prolonged dispute or court case.

Ultimately, the tactics for recovery will rest with the practitioner and his legal and professional advisors. Obtaining recompense is never going to be easy, but determination, perseverance and a little luck can take you a long way. ■



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