

FRAUD

The whole truth and anything but the truth

Andrew Beck and Gwendoline Davies take an overview of remedies for commercial fraud, deceit and bribery



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'While there may be circumstances in which it is necessary to plead fraud, parties should be mindful of the possibility that other types of claim may deliver the results they are looking for.'

Civil cases of fraud, deceit and bribery have hit the courts several times over recent months, revealing that there remains a murky side to some commercial dealings even in today's highly regulated society. This article highlights some of the legal claims and remedies that can be available to help right such civil wrongs.

'Fraud'

Under English law, there is no defined cause of action of civil or commercial 'fraud'. Instead, there is a range of options available depending on the factual circumstances of the particular case, including deceit/fraudulent misrepresentation; claims arising out of conspiracy; bribery; breach of fiduciary duty; breach of trust; and inducing breach of contract. The common theme is deliberate action on the part of the wrongdoer, usually involving dishonest conduct. Each cause of action has its own specific, constituent parts which the claimant must plead and prove.

There are a number of advantages to pleading fraud, including:

- the courts are more willing to adopt an expansive approach to the remedies available and to the measure of losses suffered by the claimant – damages are not restricted to losses which are reasonably foreseeable;
- there is no defence of contributory negligence;
- the usual limitation period for bringing a claim may be postponed,

with time starting to run instead from the date of discovery of the fraud (or from when the claimant could, with reasonable diligence, have discovered it);

- parties cannot limit or exclude liability for fraud; and
- company directors may be held personally liable in certain cases.

On the flip side, fraud allegations can have far-reaching and damaging consequences for defendants, not least because there is a stigma attached to the word 'fraud'. The courts will therefore subject a fraud plea to a rigorous degree of scrutiny, and claimants will generally be well advised not to include a plea of fraud lightly.

Recent cases have highlighted several key principles for claimants to consider.

The need for clarity

In *McEaney v Ulster Bank Ireland Ltd* [2015], various investor claimants applied to the court for permission to introduce claims of fraud against the defendant bank and investment banking firm. Broadly, the litigation concerned investments in a company owning property at London's Canary Wharf, whereby the property had declined considerably in value and the claimants had lost their investments. The application was refused because the fraud claims were made out of time, however the judge went on to say that he would also have accepted the defendants' argument that permission

should be refused because the claims were not adequately pleaded. He provided the following reminders for claimants:

- Allegations of fraud must always be properly particularised:

... the more serious the allegation of misconduct, the greater is the need for particulars to be given which explain the basis for the allegation. This is especially so where the allegation that is being made is of bad faith or dishonesty. The point is well established by authority in the case of fraud...

(observed by Lord Hope in another House of Lords case, *Three Rivers District Council v Governor and Company of the Bank of England* [2001]. Paragraph 8.2 of the Practice Direction to Part 16 of the Civil Procedure Rules provides that the claimant must specifically set out any allegation of fraud in their particulars of claim where they wish to rely on it in support of their claim.)

- An allegation of fraud is not supported merely by an allegation that the defendant made a representation that they knew or ought to have known to be untrue (*Lipkin Gorman v Karpnale Ltd* [1989]).

In other words, allegations of fraud must be clear and express and pleaded separately from any allegations of negligence, even where they are based on similar lines of argument. A 'rolled-up plea' is unacceptable.

Drawing inferences

One area of particular difficulty for fraud-claimants is proving the subjective state of mind of the defendant. In an attempt to get around this, claimants will often ask the court to draw inferences from the circumstances of the case.

In *JSC Bank of Moscow v Kekhman* [2015], the claimant had pleaded a fraudulent conspiracy and applied to the court to amend its

pleading to include allegations of fraudulent misrepresentation. The first defendant resisted, arguing that the primary facts must necessarily lead to the inference that the defendant is guilty of fraud and the particulars pleaded must be consistent only with the defendant's dishonesty.

The court disagreed – this was overstating what is required for a valid plea of fraud. The claimant

was induced to invest as a result of the defendant's fraudulent misrepresentations as to the financial position of the company. The judge made various observations regarding the claimant's case.

First, the claimant pleaded that the representations were false and made fraudulently or recklessly, the defendant not caring whether they were true or false. The judge remarked that misrepresentations

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does not have to plead primary facts which are only consistent with dishonesty. The correct test is whether or not, on the basis of the primary facts pleaded, an inference of dishonesty is more likely than one of innocence or negligence. There must be some fact 'which tilts the balance and justifies an inference of dishonesty' (per Lord Millet in *Three Rivers*). The judge went on to explain that, when the court is considering whether the plea of fraud is a proper one, it is concerned only with whether facts are pleaded which would justify the fraud plea. If the plea is justified, then the case must go forward to trial and assessment of whether the evidence justifies the inference is a matter for the trial judge.

Fraud/deceit v misrepresentation

Misrepresentation might be fraudulent, negligent and innocent. Fraudulent misrepresentation (or 'deceit') is the most serious and requires a false representation to have been made knowingly, or without belief in its truth, or recklessly as to its truth (*Derry v Peek* [1889]).

In *Hussain v Mukhtar* [2016], the claimant claimed damages for losses after investing in a company established by the defendant. He claimed that he

made recklessly, with no care as to whether they are true or false, *are* fraudulent, so that the claimant's pleading identified one cause of action only (namely fraudulent misrepresentation/deceit).

Secondly, the claimant's counsel suggested that, although the pleaded claim was primarily one of fraudulent misrepresentation, it would be sufficient for the claimant to show that the representations had been made 'negligently', relying on s2(1) of the Misrepresentation Act 1967 (the 1967 Act). Where parties have entered into a contract, a claim for negligent misrepresentation under s2(1) of the 1967 Act is available (in addition to any possible breach of contract claim) where the misrepresentation was made carelessly or without having reasonable grounds for believing its truth.

The 1967 Act provides that the same remedies (having the contract set aside and seeking unlimited damages) are available where the misrepresentation was made negligently as if it were made fraudulently, unless the person making the misrepresentation proves that they had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true.

The judge made the following points of note:

- A claim in deceit is very different from a claim under s2(1) of the 1967 Act. In a deceit claim, the claimant bears the burden of proving the defendant’s mental state (knowledge of or recklessness as to falsity); in a claim under s2(1) it is for the defendant to prove that they had reasonable grounds for believing, and did

the unravelling of contractual arrangements or the lifting of other legal or procedural rules – hence the well-established principle that ‘fraud unravels all’.

‘*Res judicata*’ is the fundamental legal and public interest principle which states that there should be finality to litigation and that defendants should not face repeated

despite the claimant maintaining in those proceedings that she did not remember signing key documentation, she did not have a positive case to assert and she did not have any evidence that her signature had been forged. Following the court’s judgment against her, however, the claimant went on to obtain evidence of forgery and, in 2013, the claimant issued a fresh claim against the defendant.

The defendant argued that the 2013 claim should not be allowed to proceed pursuant to the rules against re-litigation, particularly in circumstances where evidence of the fraud was not new and could, with reasonable diligence, have been discovered by the claimant before the 2008 trial. The claimant countered that fraud unravels all.

The Court of Appeal confirmed that, for a judgment to be set aside on the basis of fraud:

- there has to be a conscious and deliberate dishonesty in relation to evidence given, action taken, statement made or matter concealed, which is relevant to the judgment in question;
- the dishonest evidence, action, statement or concealment must be material in causing the judgment to have been obtained in the terms that it was; and
- the party seeking to set aside the earlier judgment must establish that evidence of the fraud was not available at the time of the original trial and could not, with reasonable diligence, have been discovered.

This decision represents a balancing exercise between protecting the finality of litigation and preventing the prevailing of a fraud. The best practical advice for any party who suspects the commission of a fraud is to take diligent steps to obtain evidence of any dishonesty or wrongdoing and to bring it to the attention of the court at the earliest possible

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believe, that the representation was true.

- The ingredients of the two species of misrepresentation are different. Claims under s2(1) can only be brought where the claimant has entered into a contract after the misrepresentation and only against a party to the contract; claims in deceit are not subject to either of those restrictions, and available limitation defences may also differ.
- A defendant is entitled to understand whether a claim under s2(1) is being advanced or not – a claimant wishing to advance such a claim as an alternative to a claim in deceit should plead it.

So, while there may be circumstances in which it is necessary to plead fraud, parties should be mindful of the possibility that other types of claim (such as claims under the Misrepresentation Act 1967) may deliver the results they are looking for. Such claims may even be easier to establish, but they should be clearly pleaded.

Finality of litigation v ‘fraud unravels all’

Fraud and dishonest wrongdoing are seen by the courts as so serious as to merit, in many cases,

litigation in respect of the same set of circumstances. The courts also have the power to strike out claims which amount to an abuse of process because, for example, they:

- amount to re-litigation;
- advance a case or issue that is inconsistent with an earlier judgment; or
- advance claims or arguments that could and should have been made in earlier proceedings.

The certainty and finality of litigation; the authority and supremacy of a judgment of the court; and the cost-efficiency of the court process for individual parties and for the public as a whole, all depend upon these important principles... but what is the position if an earlier judgment has been obtained by fraud?

In *Takhar v Gracefield Developments Ltd* [2017], the Court of Appeal provided important clarification of the interaction between the apparently competing principles of *res judicata* and abuse of process on the one hand, and fraud unravels all on the other.

In 2008, a claim which the claimant had issued against the defendant was rejected because,

time. If it is not possible to do that before an initial judgment is obtained, an application to set aside will have to be made, and will have to be supported with clear evidence as to how and when the fraud came to light and the steps that were taken by the applicant, both prior to the original trial and since, to prove that the fresh application does not amount to an abuse.

Bribery, dishonest assistance and equitable remedies

Finally, in the recent case of *UBS AG (London Branch) v Kommunale Wasserwerke Leipzig GmbH* [2017] the Court of Appeal considered bribery and dishonest assistance and the remedies available to victims of dishonest conduct.

Bribery is a civil wrong which is committed when payments are made to agents without their principal's knowledge or consent. For these purposes, the agency might arise via contractual arrangements, or in the context of a fiduciary relationship. Dishonest assistance, which often occurs hand-in-hand with bribery and also involves dishonest conduct, occurs where an accessory induces or assists in a breach of trust or fiduciary duty.

Many of the remedies that are available to a victim of bribery and/or dishonest assistance (as with other civil wrongs involving dishonest conduct) arise from the courts' discretionary jurisdiction to award equitable remedies as a means of ensuring fundamental fairness. Equitable remedies can include, non-exhaustively, making defendants account for any ill-gotten profits; compensating victims for any loss suffered; and/or rescinding (setting aside) contractual arrangements which have been concluded as a result of defendants' wrongdoing. When exercising its discretion, the court will apply certain key principles of equity, including:

- the equitable maxim of 'clean hands': that is, anyone looking to equity for a remedy must be free of wrongdoing him/herself;

- equity will not suffer a wrong to be without a remedy: where fairness requires, a remedy will be provided even if one does not exist by right at law; and
- the doctrine of 'laches' (delay): delay can cause unfairness in itself and so an equitable claim may be barred if it is

wrongdoing and it is a good example of fraud and equity unravelling complex contractual arrangements.

Practical advice

The checks and balances which businesses face in today's highly regulated economic environment go a long way towards preventing fraud and other wrongdoing, but where there is a fast buck to be made

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not brought within a timely manner.

In this case, a bank had reached a dishonest arrangement with financial advisers whereby they would advise clients to enter into debt obligations with the bank even where this was in conflict with the clients' interests. The financial advisers then heavily bribed the managing director of a client company to enter debt obligations with the bank, which the company then did.

The court found that, while the bank may have been unaware of the bribe, nevertheless it had knowingly assisted in the financial advisers' breach of fiduciary duty to the client company. By contrast, the state of mind of the managing director (that is, his knowledge of the bribe and therefore of the fraud against the company) could not be attributed to the company itself (the victim). The court also noted that, by virtue of its corrupt arrangement with the advisers, the bank did not have clean hands. For all these reasons and, of course, the bribery, the court exercised its direction to rescind the debt contracts, thereby allowing the client-victim to escape some \$400m of unsuitable obligations.

The case confirms the broad reach of liability for dishonest assistance in cases of bribery and other fraudulent

there will always be some people who resort to dishonest means. For those who suffer loss as a result, while pleading fraud may not be an easy option, recent cases show that it will be taken seriously by the courts and that it can offer a variety of suitable and flexible remedies. In such claims, acting fast, conducting yourself correctly and properly pleading your claim can prove essential to success.

So remember: act fast, come clean, seek specialist advice and equity can provide a fair result against fraud. ■

Derry v Peek
[1889] UKHL 1

Hussain v Mukhtar
[2016] EWHC 424 (QB)

JSC Bank of Moscow v Kekhman & ors
[2015] EWHC 3073 (Comm)

Lipkin Gorman v Karpnale Ltd
[1989] 1 WLR 1340

McEaney & ors v Ulster Bank Ireland Ltd & anor
[2015] EWHC 3173 (Comm)

Takhar v Gracefield Developments Ltd & ors
[2017] EWCA Civ 147

Three Rivers District Council v Governor and Company of the Bank of England
[2001] UKHL 16

UBS AG (London Branch) v Kommunale Wasserwerke Leipzig GmbH
[2017] EWCA Civ 1567