Fall 2015

# The FraudNet Report

*From the World's Leading Asset Recovery Legal Network*

*Ranked by Chambers Global*

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***Save the Date:***
*FraudNet's Fall Meeting Oct. 2, 2015.*
*Steigenberger Hotel Herrenhof,*
*Vienna, Austria.*

A message from Stephane Bonifassi, executive director of ICC FraudNet, about

# *The FraudNet Report*

*This newsletter about fraud & global asset recovery is published by ICC FraudNet, a highly select network of independent, world-class asset recovery attorneys in countries around the world.*

In recognition of fraud's increasing sophistication, speed and global dimensions, in 2004 the International Chamber of Commerce (ICC), the world business organization headquartered in Paris with offices in 70 countries, founded the FraudNet network under the auspices of its London-based Commercial Crimes Services unit.

FraudNet is a 24/7 international rapid deployment force that pries open the vault of bank secrecy and helps victims chase down and recover their stolen assets with the same cyber-powered speed, stealth, reach and proficiency as the most sophisticated global fraud network.

Using sophisticated technical investigations and forensics, as well as cutting-edge civil procedure, members of ICC FraudNet have recovered billions of dollars for victims of some of the world's largest and most sophisticated global frauds involving insurance, commodities, banking, grand corruption and bankruptcy/insolvency. We have expert, on-the-ground representation in all of the world's top financial centers and offshore bank secrecy havens and work closely with law enforcement when MLAT requests and criminal asset forfeiture are required.

This newsletter will provide members of FraudNet, organizations representing institutional and individual victims of fraud, and other interested parties with regular updates on the progress of key asset recovery cases and new developments in procedural tradecraft. Our *Report* will also present interviews with FraudNet lawyers and news from FraudNet conferences.

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# Plugging the Digital Data Breach:

## *FraudNet Helps Retrieve Stolen Customer Data*

Money isn't the only asset that is proving increasingly vulnerable to electronic theft and cross-border transfer. Customer data can be just as valuable to a business, and in digital form, just as vulnerable to the growing threat of cybercrime.

Fortunately, advanced asset-tracing and recovery tools developed to combat financial frauds are being applied with equal success to recover stolen customer data. In one recent case, FraudNet members from Ireland and Canada scrambled a rapid response team to recover data from a limited and isolated breach at an international online gaming company.

"This was an unusual case four years after a breach had been detected, but no perpetrators had been identified. Suddenly, we learned that a customer dataset was in the hands of an identified individual in Canada," explained FraudNet member Gregory Glynn, a partner at Arthur Cox, Dublin.

Glynn quickly called on his FraudNet colleague Lincoln Caylor, a partner in the Toronto office of Bennett Jones. Caylor immediately contacted Canada's Commissioner of Data Protection and the Ontario Provincial Police.

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Gregory Glynn

*Because Canadian government, police and judicial systems worked together, FraudNet was able to plug the client's data breach very quickly.*

*The stolen customer dataset was seized from an unauthorized Canadian individual, returned to the client, and deleted from the individual's IT systems.*

## Hitting the Legal 'Delete' Button

"After verification using a sample from the dataset being held by the Canadian individual, we quickly sought and received two court orders in Canada to seize the misappropriated IT assets, recover our client's entire dataset, and delete it from the individual's IT systems," Caylor said. "These orders also allowed us to examine the subject's bank accounts and financial transactions and to question him in coordination with the police."

After the entire dataset was recovered, it was examined forensically by the client's information security team. That examination determined, with precision, that some non-financial personal information relating to a subset of the company's customers in 2010 was compromised during one isolated cyber-attack that year.

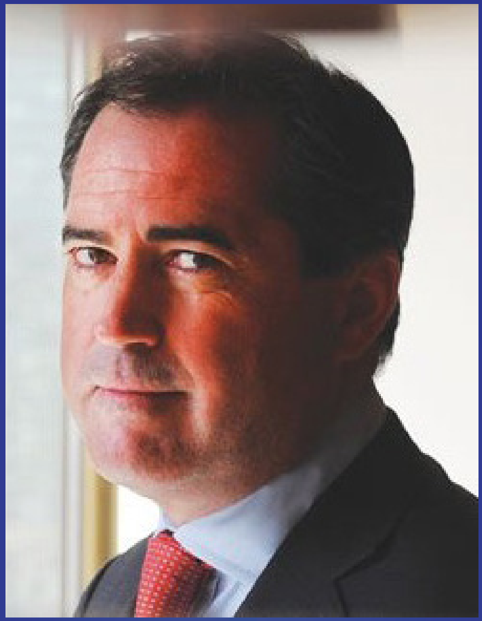
## Understanding the Scope

The company's full investigation revealed no evidence that customers' accounts were adversely impacted. Nor was there any impact at all on customers who opened accounts after 2010.

"The dataset we seized in Canada certainly confirmed that only limited, non-financial customer information had been exposed back in 2010," Caylor said. "No actual passwords or bank account or credit card details had been taken."

The stolen data was limited to various customers' names, usernames, addresses, e-mail addresses, phone numbers, dates of birth, and/or prompted question and answers.

Nevertheless, according to Glynn, "The client, which places a premium on security, was extremely happy to get its customers' personal data out of the wrong hands, and to finally learn, with precision, what data had been taken and which customers should be notified so they could protect themselves from any possible consequences."



Lincoln Caylor

*FraudNet members from Ireland and Canada scrambled a rapid response team to recover a stolen customer dataset from the wrong hands.*

## Proof of Concept

Caylor concluded: "This case was very gratifying for us, and a real proof-of-concept for advanced forensics and coordinated legal action across borders in the evolving data protection space. Because government, police and judicial systems worked together, we were able to plug this breach very quickly after we located the misappropriated data."

He continued: "Nothing disappears faster than data. Yet, as this case also demonstrates, nothing is more persistent and long-lived than misappropriated customer data in the hands of those who want to sell it and 'milk it' like the gift that keeps on giving. FraudNet's teamwork really demonstrated our network's global reach and rapid response capability in quickly shutting down this kind of misuse years after the data was stolen."

## A Second Line of Defense

"Given the growth and ubiquity of online commerce," Glynn pointed out, "it's useful to think of data retrieval through concerted police and legal action as 'stage II' of data security. Banks and other businesses transacting with their customers online can be reassured that despite state of the art security systems, if and when a breach occurs, FraudNet has an established track record and a network of experts on the ground who can be called into action around the world. In effect, we can help plug a data breach after the fact, and do this very rapidly."

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*Even the most advanced IT security can't prevent every incursion. Legal action after a breach can function as backup or second-stage security.*

# Representing Creditors in Complex, Massive Life Settlements Fraud

A massive fraud doesn't necessarily have to be built Ponzi-style, from the ground up, on the basis of a totally illusory product or service. The current Chapter 11 bankruptcy of publicly traded viatical and life settlement company Life Partners Holdings, Inc., proves that complex and otherwise legitimate financial products may be the perfect vehicles for fraud.

According to news reports earlier this year, Life Partners' bankruptcy trustee struggled for months to unravel the complexities involved in the company's allegedly fraudulent marketing and sale to retail investors of fractional interests in life insurance policies on elderly and critically ill individuals. Following a 2014 U.S. District Court judgment of $46 million in a civil enforcement action (including penalties of $35 million) by the U.S. Securities and Exchange Commission (SEC), Life Partners sought Chapter 11 protection in January 2015.

FraudNet member firm Munsch Hardt, Dallas, was selected to represent the Official Committee of Unsecured Creditors in *In re Life Partners Holdings, Inc., et al.* in the ongoing bankruptcy in the Northern District of Texas.

## Legitimate Product Subverted

"Life Partners was a founding player in the viatical and life settlement industry in the United States, which has been plagued for decades by allegations of fraud," explained Munsch Hardt shareholder Joe Wielebinski. Essentially, the company served as a broker and servicer for an investment involving the purchase of a fractional interest in life insurance on another person.

Joe Wielebinski

*Complex alternative investment vehicles may be the perfect vehicles for fraud.*

Wielebinski pointed out: "The basic industry model is sound. It represents value both to insureds, who obtain immediate cash value from their policies when they need it, and to investors, who have the opportunity to reap huge returns if insureds die earlier than expected."

Over the years, Life Partners grew a portfolio in excess of 3,500 policies with an aggregate face value exceeding $2.4 billion, and more than 20,000 investors. Prior to its bankruptcy, its parent holding company was publicly traded on NASDAQ with an impressive record of paying dividends to stockholders, the largest of whom were the company's founder and his family trusts.

"However, unbeknownst to investors, Life Partners allegedly subverted what was otherwise a legitimate business enterprise offering a genuinely viable product. One of the most pernicious aspects of this apparent scheme, and one of the hardest to unravel," Wielebinski said, "has been the company's use of fraudulent life-expectancy analyses and inflated commission structures to engage in and conceal various lucrative transactions."

## Third-Party Marketing Conceals Fraud

According to the court-appointed bankruptcy Trustee Tom Moran, Life Partners participated in a coordinated scheme with certain escrow companies and "licensees" marketing its product. Together, it's alleged that they colluded to grossly inflate and not disclose the actual costs to Life Partners of obtaining its underlying life insurance policies.

In some cases, he explained, the costs of those policies were doubled in order to derive substantial undisclosed commissions, fees, and other income from the sale of fractional interests in the policies to unwitting investors.

Moreover, throughout its operation, Wielebinski noted, Life Partners zealously maintained the confidentiality of virtually all investor and investment records and data. In part, this was to withhold information from investor-customers that would allow them to move the servicing of their policies to other providers and ascertain what they actually paid for their fractional interests.



*Life Partners served as a broker and servicer for an investment involving the purchase of a fractional interest in life insurance on an elderly or critically ill person.*

## Manipulating the Re-Sale Market

"But first and foremost," he pointed out, "total records secrecy allowed Life Partners to control the secondary market for re-sale of investors' fractional interests by controlling all the information critical to that market's functioning."

Investors whose policies were in danger of lapsing due to nonpayment of premiums due from other fractional investors could agree to resell their own fractional share on the secondary market. However, without information held secret by Life Partners, potential sellers could not know whom their joint investors were or how much they were failing to pay. Nor could they know the identities of the secondary purchasers acquiring their interest at a discount.

In reality, Wielebinski said, "Life Partners, itself, as well as certain company principals and affiliates, often held the other fractional interests on policies in danger of lapsing. In many cases, they also were the secondary market purchasers."

Thus, Life Partners, its principals and affiliates were allegedly able to manipulate the secondary market to drive re-sales and derive revenues therefrom. "In essence," he explained, "Life Partners preyed on its own customers by purchasing their interests at steep discounts."

## Coming Under Securities Law

In the SEC litigation in Austin, a federal court found that Life Partners' investment products constitute securities under U.S. law. This subjected the company to corresponding disclosure requirements, which led to the Austin jury's false financial reporting ruling and the massive judgment precipitating Life Partner's bankruptcy filing.

According to Wielebinski, "Life Partners and certain of its co-defendants appealed rulings under U.S. and Texas law that the company's investment products are securities and subject to trading and reporting regulations." However, on May 8, 2015, the Texas Supreme Court affirmed that Life Partners' products are, indeed, securities.

*Life Partners used artificially short life-expectancy estimates on insureds to make it seem that policies would pay out sooner, boosting their investment value.*

*Victims claim Life Partners preyed on its own customers by secretly driving re-sales on the secondary market and purchasing its customers' interests at steep discounts.*

*Just prior to its bankruptcy filing, the company paid millions of dollars in dividends to its founder and his family trusts.*

## Winning Trustee Appointment

Munsch Hardt's involvement began in January at the onset of the bankruptcy case. In a six-day trial, the firm represented Life Partners Creditors' Committee relating to a request by the SEC and the United States Trustee for the appointment of a Chapter 11 Trustee.

"The bankruptcy court granted that request based on gross mismanagement, including the payment of millions of dollars in dividends to equity holders in Life Partners just prior to the bankruptcy filing," Wielebinski said. "These payouts occurred at the same time that Life Partners was retroactively charging its investors a new fee to maintain its depleted cash flow, as well as making misleading public disclosures about the bankruptcy."

According to *The Deal,* in May 2015, Chapter 11 Trustee Tom Moran said he had found that Life Partners used artificially short life-expectancy estimates on insureds to make it seem that policies would pay out sooner, boosting their investment value. The same allegation had been made against Life Partners by the SEC.

Likewise, according to *The Deal,* Moran alleged that the company had misrepresented expected investment returns and whether policies had lapsed, and had "re-sold lapsed policy interests, charged undisclosed fees, misrepresented the company's business practices to skirt securities regulations, committed self-dealing, failed to disclose cash value in policies, and forced investors to abandon policy interests that were re-sold for personal gain."

## Pursuing Third Parties, Fraudulent Distributions

Wielebinski noted that the Creditors Committee has coordinated with Trustee Moran with respect to his attempts to preserve Life Partners' underlying insurance portfolio, dispose of select assets, formulate a proposed Chapter 11 plan, and other estate administration. Claims are estimated to exceed $1.5 billion.

*Offshore entities that received distributions likely will be among the targets of victim litigation seeking hundreds of millions of dollars in fraudulent transfers and damages.*

He predicted: "This case is also likely to involve substantial litigation seeking the recovery of hundreds of millions of dollars in fraudulent transfers, and damages arising from other questionable activities by the company's former principals, insiders, licensees, and other related parties. Although it's still early in these proceedings, I expect offshore entities that received distributions to be among the litigation targets."

There is also one poignant, almost unbelievable aspect of the fraud's aftermath. "Having defrauded investors through what was otherwise a legitimate alternative investment vehicle," Wielebinski said, "in a very real sense, Life Partners' legacy of deception lives on."

He explained, "Many of the investors that Life Partners deceived for years are now deceiving themselves that the company should be allowed to continue operating in the normal course. One can't blame them for believing in the business the way it should have been, but now so clearly wasn't. It's really very sad."

# Insolvencies Spur Spain to Crack Down on Corporate Fraud

On the heels of the high-profile, high-impact insolvencies of Spanish companies Pescanova and Gowex, the Spanish Criminal Code has been amended to expedite the punishment of corporate fraud resulting in insolvency. Specifically, Article 259 of the code newly specifies which behaviors will trigger the criminal prosecution of executives and officers who, through mismanagement or negligence, drive their companies over the cliff.

"This is a welcome change for investors and creditors, not only because it will expedite prosecution of corporate criminals, but also because of the enhanced deterrent effect," said FraudNet member Fernando Gonzalez, a partner in Squire Patton Boggs, Madrid. "With greater legal clarity comes greater certainty that crimes of this nature will be prosecuted and punished."

One of the hallmarks of the amended law is its new focus on preventing debtor-insiders from looting and hiding assets from an insolvent entity that otherwise could be used to pay creditors.

## Events Led Legislators to Act

"Two huge insolvencies that made big news in the Spanish and global media no doubt gave Spanish legislators the impetus to act," Gonzalez explained. Perhaps the most infamous involved Pescanova, S.A., one of the world's largest fish companies with fleets, farms, and processing plants manned by 10,000 employees all over the world.

*"With greater legal clarity comes greater certainty that crimes of this nature will be prosecuted and punished. There will also be an enhanced deterrent effect." –Fernando Gonzalez, Squire Patton Boggs, Madrid.*

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Fernando Gonzalez

According to *Reuters*, stockholders of publicly traded Pescanova lost 99 percent of their investment between Jan. 1, 2013 and the indefinite suspension of trading two months later, when the company said it may have misstated its accounts. Major creditors of the insolvency, which was filed in April 2013, included a bank restructuring fund that nationalized two Galician savings banks that had lent Pescanova hundreds of millions of euros.

## Pescanova Fraud

Gonzalez cited an external audit by KPMG finding that Pescanova had falsified its internal accounting for years, shuffling money around in an elaborate shell game among 89 onshore and offshore affiliates. *Reuters* also reported this spring that the Spanish court had finalized a restructuring plan for 10 of the company's units.

Creditor banks are expected to take over the seafood giant in the fourth quarter of 2015, after shareholders vote to back the court's restructuring plan. Other media recently reported the seizure by Spanish authorities of 29 properties solely owned by former Pescanova Chairman Manuel Fernandez Sousa-Faro through a shell company.

## The Case of Gowex

Wireless networks provider Gowex, S.A., is another publicly traded Spanish company whose assets and resources were mismanaged into bankruptcy, according to *Reuters*. In July 2014, the news agency reported, Gowex filed for bankruptcy one week after an accounting fraud at the company was revealed.

Former Chief Executive and Chairman Jenaro Garcia Martin admitted he had misrepresented the company's financial status from at least 2010 to 2014. He subsequently was charged with accounting fraud, distortion of economic and financial information, and insider trading. According to *Reuters,* Martin could face a jail term of more than 10 years.

## Clearer Boundaries in the Law

"Both of these major insolvencies underscore the importance of clear legal boundaries that have now been more firmly established in the law," Gonzalez said. "The new Article 259 sets boundaries that cannot be crossed without corporate insiders being held legally liable for failing to exercise the duty of diligence on behalf of their companies, creditors, and the economy as a whole," Gonzalez said.

Likewise, once insolvency has occurred, the amended article newly punishes acts such as altering finicial records or hiding or looting assests that should be available to pay company creditors.

In addition to deliberate fraud, negligence, or mismanagement, the amended article also imposes penalties in cases where insolvency has resulted from imprudence in subjecting the company to undue financial risk.

*Altering financial records or hiding and looting company assets once an insolvency has occurred will also be punished.*

# Civil Law Recovery Successes in Switzerland

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Asset recovery attorneys in the civil law countries of continental Europe, most of Latin America, and much of Africa and Asia can feel at a disadvantage when comparing their legal arsenal to that of their common law counterparts.

However, while the remedies at the disposal of the civil asset recovery lawyer may be less sophisticated than those available under common law, they do not lack efficiency--and may actually be less costly for the victim.

As proof, FraudNet member Yves Klein of Monfrini Crettol & Associés, Geneva, cites a number of recent recoveries in Switzerland.

“Switzerland is a civil law jurisdiction where bank secrecy was considered virtually impenetrable,” Klein noted. “Yet in several major international recoveries since 1999, Swiss justice has played a primary role.”

For example, he noted, “Since 1999 our firm has recovered USD $2 billion for the government of Nigeria, and we are currently in the process of helping Tunisia pursue redress for grand corruption schemes by its former leaders.”

Criminal forfeiture and anti-money laundering laws are highly effective anti-fraud weapons in Switzerland, Klein explained. As a result, the Swiss civil recovery lawyer often will work hand-in-hand with law enforcement authorities, representing a plaintiff through completion of criminal proceedings without ever appearing before a civil court.

However, that may not be the case in large and complex recoveries, he pointed out.

Yves Klein

*Civil law recovery tools may be less sophisticated than those based in common law. But they are efficient and may even be less costly for the victim.*

"Such cases often will also involve bankruptcy, civil, and enforcement proceedings--usually in that order. This is particularly true when the actual proceeds of the crime have been dissipated or transferred to jurisdictions where asset recovery tools do not exist. In these instances, lawyers for the victim must look beyond proceeds and bring actions for damages against third-party abettors or facilitators of the crime."

## Full Admission to Criminal Proceedings

In both the Abacha (Nigerian) and Ben Ali (Tunisian) recoveries, respectively, defrauded governments became parties to criminal complaints in the Swiss courts. In the Ben Ali recovery, criminal proceedings were initiated against associates of the late dictator by the Attorney General's Office of Switzerland on suspicions of money-laundering, corruption and participation in a criminal organization.

In the Abacha case, Nigeria lodged a criminal complaint against members of the entourage of its former head of state with the Attorney General of Geneva citing fraud, embezzlement, participation in a criminal organization, and money-laundering.

"Under Swiss law, direct victims can be admitted as plaintiffs to criminal proceedings from the very start of the investigation," Klein noted. "And once admitted, in most cases victims are entitled to full access to criminal files with the right to copy them and to use the evidence collected in support of proceedings in Switzerland or abroad."

According to Klein, criminal plaintiffs are also entitled to participate in the examination of suspects and witnesses, and to request evidence and witness production and freeze orders in Switzerland and worldwide.

"The plaintiff thus becomes the engine that powers the criminal investigation, especially when it can provide supporting material from its own multi-jurisdictional team of asset recovery professionals, including lawyers, investigators, and forensic accountants."

## Criminal Forfeiture of Assets

Swiss criminal law favors settlements between perpetrators and victims. "Absent a settlement," Klein explained, "victims may bring a claim for damages against perpetrators within the context of a criminal trial."

In judgment of a crime, criminal courts can cause defendants to forfeit assets to the plaintiff, as well as to award the plaintiff damages. Such monetary judgments are recognized and enforceable as foreign civil judgments in most jurisdictions around the world, including those under the common law tradition.

And even when a criminal trial is impossible, an order of forfeiture can still be issued against proceeds of crime or their replacement value, Klein pointed out. "That's how strong the rights of victims are under Swiss law. Forfeiture and the allocation of proceeds to the plaintiff in satisfaction of a judgment or settlement are not discretionary, but must be ordered when their legal conditions are met."

*In cases where third parties have facilitated money-laundering to hide stolen assets and hinder recovery, Swiss case law is the victim's friend.*

## Suing Third Parties

It often happens, however, that the harm caused by economic crimes exceeds, by far, any assets that can be recovered from the main perpetrators. In these cases, the best strategy for value recovery is to initiate civil actions for damages against facilitators of the crime.

According to Klein, "One of the most fruitful strategies along these lines is to first employ insolvency or receivership proceedings to seize control of the Swiss or foreign companies that have been plundered."

Third-party agents and contractors of the plundered company, such as its bankers and accountants, subsequently can be sued for breach of their contractual duties leading to insolvency. Absent a formal contractual arrangement, a tort action for recovery may be brought.

In cases where third parties have facilitated money-laundering to hide stolen assets and hinder recovery, Swiss case law is again the victims' friend. It provides clear precedents for recovery of damages from individuals who have intentionally engaged in money-laundering to prevent the recovery of the proceeds of a crime.

## Corporate Criminal Liability

When proof of intent is too difficult to bring, Article 102, Section 2 of the Swiss Penal Code may come into play. Irrespective of any individual criminal liability, it allows crimes of corruption, money-laundering and support of a criminal or terrorist organization to be imputed to a company if it is found to have failed to take reasonable preventive measures.

"This is just what happened in 2014 in Swiss criminal proceedings relating to the bankruptcy and liquidation of Stanford International Bank," Klein pointed out. SIB had collapsed in 2008 under one of the largest Ponzi schemes in history—second only to the scheme by Bernard Madoff. In February 2009, the federal Attorney

### Limits to Asset Recovery under Civil Law:

- *Plaintiffs can't obtain civil orders compelling a defendant or third party to disclose information or evidence for use in other proceedings.*

- *Judgments are enforceable only against listed defendants, and will only exceptionally be extended to the offshore companies or trusts they beneficially own.*

- *Attachment orders, in most cases, are available only when the plaintiff has an enforceable judgment.*

*The Swiss Penal Code allows crimes of money-laundering to be imputed, irrespective of any individual criminal liability, to a company provided it is found to have failed to take reasonable preventive measures.*

General's Office of Switzerland initiated criminal proceedings on suspicions of money-laundering following the collapse of the Stanford financial empire. In May 2009, the Joint Liquidators of Stanford International Bank, Ltd. (SIBL), Antigua, applied to Swiss authorities for recognition of the Antiguan insolvency proceedings. This was granted in June 2010, and led to the opening of an ancillary Swiss bankruptcy.

In late 2012, SIBL was admitted as a plaintiff in Swiss criminal proceedings. Then in February 2014, the Swiss attorney general issued a sentencing and forfeiture order against a Swiss subsidiary of the Stanford Group, finding it had committed money-laundering due to a lack of reasonable preventive measures.

This order resulted in fines and a forfeiture of assets by Stanford's Swiss subsidiary, followed by the allocation of forfeited assets and fines to the ancillary Swiss bankruptcy of SIBL. The amount of the allocation was based on a determination of the criminal proceeds, as well as amounts due to compensate SIB creditors for their loss.

Klein concluded, "We have brought similar actions against banks in the Nigerian, Tunisian and Stanford cases as a consequence of their being found criminally liable for money-laundering and civilly liable for damages to our clients. In each of these cases, the damages sought exceed USD $100 million, and we expect to obtain decisions in first instance during 2016."

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# Strategic Partners:

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