

Fraud: History, Issues, Tools and Challenges

William Brock, Ad. E.
Marc-André Boutin

November 6, 2012



Fraud: History, Issues, Tools and Challenges

“Fraud is infinite in variety; sometimes it is audacious and unblushing; sometimes it pays a sort of homage to virtue, and then it is modest and retiring; it would be honesty itself if it could only afford it. But fraud is fraud all the same and it is the fraud, not the manner of it, which call for the interposition of the Court.”

Reddaway v. Banham, 1896 A.C. 199, p. 221.

Fraud: History, Issues, Tools and Challenges

Presentation Layout

- What Is Fraud?
- Time Capsules
- Profile of Fraud Today
- Impact of New Technologies
- Canadian Remedies
- Measures to Help Prevent and React to Fraud



What Is Fraud?

DAVIES

What Is Fraud?

“The fertility of man's invention in devising new schemes of fraud is so great, that the courts have always declined to define it, [...] reserving to themselves the liberty to deal with it under whatever form it may present itself.”

Kugler v. Romain, (1972) 58 N.J. 522, p. 543.

- Legislators and the courts have been reticent about defining fraud other than in general terms.
- General definition of Section 380 of the *Criminal Code*:

“Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service.”

What Is Fraud?

- Although it is more precise that the famous “I know it when I see it” of Judge Potter Stewart (*Jacobellis v. Ohio*, 378 U.S. 184), the definition adopted by Canadian legislators reflects a desire to leave the application general.
- Certain specific cases of fraud are identified in the *Criminal Code*:
 - Destroying documents of title (documents of title, official documents, etc.) for a fraudulent purpose: s. 340 *Cr.C.*
 - Theft, forgery, etc. of credit card: s. 342 *Cr.C.*
 - Unauthorized use of computer: s. 342.1 *Cr.C.*
 - False pretence or false statement: s. 362 *Cr.C.*
 - Fraudulent manipulation of stock exchange transactions: s. 382 *Cr.C.*
 - Fraudulent sale of real property: s. 387 *Cr.C.*
 - Identity fraud: s. 403 *Cr.C.*

and certain offences are provided for in other acts (e.g. *Competition Act*, s. 52 regarding false or misleading representations).

What Is Fraud?

- Dishonesty and deprivation or the risk of deprivation are two key concepts of fraud in Canadian criminal law:

“Fraud consists of being dishonest for the purpose of obtaining an advantage and which results in prejudice or a risk of prejudice to someone’s “property, money or valuable security”. There is no need to target a victim to commit fraud, and the victim may not be ascertained.” (*Vézina v. Q.*, [1986] 1 S.C.R. 2, p. 19).

- In civil law, the concepts of deceit, contractual and extracontractual liability and the general obligation of good faith encompass the notion of fraud.
- The origin of the word fraud comes from the Latin *fraus* or *fraudis* “harm done to someone” and matches the civil and contractual liability regime.



Fraud Time Capsules



Fraud Time Capsules

- Fraud and the fight against it can be traced back to the earliest writings.
- The concept of fraud is found in Greek mythology where Apate, the personification of deceit, perfidy, fraud, trickery and dishonesty, is one of the evils contained in Pandora's Box.



Fraud Time Capsules

Fraud is found in the great civilisations of Antiquity:

- In Ancient Egypt, scribes were assigned to the monitoring of the pharaohs' incoming and outgoing grain and gold inventories so as to prevent fraud and theft.
- In Greek civilisation, Aristotle reports on the fraud surrounding the enactment of the *Seisachtheia*, or Solon's shaking-off of burdens in the 6th century BC, which released the Greeks from slavery for debts.
- In Roman times, Cicero's *Verrine Orations* attest to the multiple thefts and the fraudulent collection of tax proceeds by Verres, the Governor of Sicily.

Fraud Time Capsules

The major religious texts also address the concept of fraud:

- The Torah

“Thou shalt not have in thy bag divers weights, a great and a small. Thou shalt not have in thine house divers measures, a great and a small. But thou shalt have a perfect and just weight, a perfect and just measure thou shalt have: that thy days may be lengthened in the land which the LORD thy God giveth thee. For all that do such things, and all that do unrighteously, are an abomination unto the LORD thy God.” (*Deuteronomy 25.13-16*)

- The Quran

Narration of the destruction of the Madyan cities by an earthquake because of the Madyans’ refusal to cease commodity fraud despite Prophet Shuaib’s imprecations to that end (*Quran VII, 85-93*).

Fraud Time Capsules

Surat 83 dedicated exclusively to defrauders begins thus:

“Woe be unto those who give short measure or weight; who, when they receive by measure from other men, take the full, but when they measure unto them, or weigh unto them, they cause [them] loss. [...]” (*Quran* LXXXIII, 1-3)

- The Bible also weighs in and states:

“A false balance is abomination to the Lord: but a just weight is his delight. [...]”

The getting of treasures by a lying tongue is a vanity tossed to and fro of them who seek death.” (Proverbs 11.1, 21.6)

Fraud Time Capsules

Fraud is also found in less ancient times:

- In the Middle Age, fraud is centred on staple goods and tax collection.
- With the development of trade and increase in exchanges, the Renaissance sees currency fraud proliferate.
- Coin clipping became a scourge in England during the 17th-18th centuries.
- The *South Sea Bubble* founded in 1711 is a magnificent illustration of a frenetic purchase of shares, at an artificially inflated price, followed by a fraudulent crash in 1720.

Fraud Time Capsules

Fraud is also found in more modern times:

- 19th century: new dimension of accounting manipulations
 - Proliferation of business corporations
 - New corporate stakeholders
 - Lack of accounting standards or serious scientific foundations
 - Consequences:
 - Overestimation of earnings
 - Anticipation of hypothetical profits
 - Dissimulation of profits for self-financing purposes

Fraud Time Capsules

- Who is Charles Ponzi?
 - Italian immigrant who arrived in the U.S. in 1903
 - Creation of the *Securities and Exchange Company* in 1920
 - System of postal coupons taking advantage of the devaluation of European currencies
 - Reimbursement of the high returns promised by new investors' funds
 - Use of professional vendors and advertisers to boost a business
 - *Boston Post* article and collapse of the system
 - Investors lost some 20 million dollars (230 million in 2012 dollars) within 8 months!
- The Bernard Madoff and Allen Stanford frauds discovered in the U.S. in 2008 and 2009, which swallowed up 65 and 9.2 billion dollars respectively, were Ponzi pyramids.





Profile of Fraud Today



Profile of Fraud Today

- **Corporate fraud** costs Canadian companies a total of 3.2 billion dollars annually, according to the CGA Association. (*Workplace Fraud, 2011*)
- Based on a 2011 survey conducted by PricewaterhouseCoopers, 32% of the Canadian companies surveyed stated they had been victims of fraud within the 12 months preceding the survey.
- **The areas of activity** where economic crimes against corporations occur most frequently worldwide are :
 - Communications
 - Insurance
 - Hotel Industry and Recreation
 - Financial Services
 - Retail Trade

Profile of Fraud Today

- The most extensive **economic crimes** worldwide are:
 - Misappropriation
 - Accounting fraud
 - Influence peddling and corruption
 - Cybercrime

- **External fraud** comes primarily from :
 - Consumers (29%)
 - Suppliers (18%)
 - Subcontractors (10%)

Profile of Fraud Today

- **Profile of a typical internal fraudster:**
 - A man (in more than 3/4 of cases)
 - Between 36 and 55 years of age (3/4 of cases)
 - Intermediate and senior manager (2/3 of cases)
 - More than 10 years of service (1/3 of cases)
 - Acts in collusion with others (2/3 of cases)
 - Works in the Trading/Accounting/Finance Department
 - The key factors leading to fraud are personal financial needs, opportunity and greed.

(KPMG, *Profile of a Canadian Fraudster*, 2012)

Profile of Fraud Today

- **Fraud by directors and officers:**

- A rare phenomenon, but makes media headlines
- Major losses for shareholders and creditors
- Undermines investor confidence in the market

- **Recent cases:**

- Canada: Bre-X, Cinar, Mount Real, Hollinger, Norbourg
- U.S.: WorldCom, Enron, Bernard Madoff, Allen Stanford

- **Types of fraud committed by directors and officers:**

- Misappropriation
- Manipulation of financial results
- Lack of disclosure, incomplete or misleading disclosure

- **Catastrophic effects on market capitalization and the company:**

- For Enron and Worldcom, the market capitalization losses totalled 200 billion dollars!
- Cinar's share price dropped from 44.50 dollars to less than 3 dollars within a few months following allegations of fraud and embezzlement!

Fraud against consumers:

- Lack of recent reliable data on fraud against consumers in Canada.
- In 2007, a Competition Bureau study estimated the direct losses associated with 12 types of mass marketing fraud at 450 million dollars, including unreported or unquantified fraud.
- Some data on **reported** fraud are available. Thus, in 2011, the reported losses attributable to mass marketing fraud in Canada totalled over 65 million dollars.
(Anti-Fraud Centre, *2011 Annual Statistical Report*).
- Most cases of mass marketing fraud are not discovered, are not reported or cannot be quantified by the plaintiffs. They are therefore not included in this figure.
- The aggregate amount for all types of fraud against consumers is much higher.

Profile of Fraud Today

- In 2010, the amounts of credit card fraud totalled some 366 million dollars.
(Canadian Bankers Association, 2011)
- Canada-wide, 81,554 incidents of fraud were detected by the police in 2010 and some 18,000 individuals were accused of fraud, all types of fraud combined. These figures include the following instances: criminal abuse of trust, fraud, fraudulent credit card related activities and computer use for fraudulent purposes.

Profile of Fraud Today

- The most extensive types of **cyber fraud** against consumers:
 - Identity theft and fraud
 - Credit card fraud
 - Fraudulent emails/phishing
 - Malware/Spyware
 - Thefts and sale of personal information by employees
 - Fraud related to investments and securities
 - False websites
 - 419 fraud or advance payment scams
- In 2011, an average of 18 events of data violation were observed per Canadian public company (Telus-Rotman, *2011 Joint Study on Canadian IT Security Practices*).



Impact of New Technologies

DAVIES

Impact of New Technologies

- Changes in the way property is owned and safeguarded (e.g. personal data + electronic support)
- Increased use of credit/debit cards in transactions
- Increased use of electronic transfers of funds
- Increased and facilitated accessibility to sensitive information for individuals inside or outside the targets
- Ease of mass approach
- Anonymity of the approach
- Targeting of vulnerable groups
- Swiftiness of transactions

Impact of New Technologies

- Impunity of fraudsters abroad
- Reduced cost of mass fraud tools
- Multijurisdictional context of frauds
- Bank secrets, legal fiction and their matching with the new reality
- Increasing difficulty to retrace the proceeds of crime



Canadian Remedies

DAVIES

- New technologies have contributed to the appearance of new types of fraud.
- What is the recourse for a company that believes it is a victim of such a crime?
- Besides civil proceedings against the perpetrator of the fraud or third parties (ex. auditors, banks/lending institutions, directors, etc.), certain out-of-court remedies allow victims of fraud to access the computers and other electronic supports used by the fraudster to find and save, even in escrow, the evidence needed for a lawsuit and the assets likely to satisfy a potential final judgment.

- The types of recourse to be addressed are:
 - Seizure before judgment
 - *Mareva* type injunction
 - *Anton Piller* order
 - *Norwich Pharmacal* order

Seizure before judgment

- Section 733 *C.C.P.*
- Legal authorization required
- Reason to fear (objectives) that the recovery of a plaintiff's debt may be in jeopardy (e.g. intent to defraud)
- Need to know the existence and location of the plaintiff's property
- Greater protection (than the *Mareva* injunction) for known property:
 - Seized property is under "judicial control"
 - Third-party seizures are parties to the legal proceedings and therefore bound by the judgments
 - Possibility of removing property and entrusting it to a custodian other than the debtor

***Mareva* type injunction**

- Essentially, the purpose of such an injunction is to prevent a defendant from disposing of or binding his property before the creditor has established his right by way of a judgment in order to protect the applicant's right to an eventual judgment.
- *Mareva* injunctions are named after *Mareva Compania Naviera SA c. International Bulkcarriers SA (The Mareva)* (1975), [1980] 1 All E.R. 213, the first such injunction in *Common Law* in England.
- The existence of the same recourse in Canada was confirmed by the Supreme Court in *Aetna Financial Services v. Feigelman*, [1985] 1 S.C.R. 2.

- The basis for the relief in Québec is Section 752 C.C.P
- The injunction may target:
 - Assets in Québec or outside the jurisdiction thereof
 - All or some assets of the defendant
- The injunction may target parties domiciled in Québec or outside the jurisdiction thereof:
 - Normally, but not always, the defendants targeted by a *Mareva* injunction are subject to the jurisdiction of the court that issues such injunction.
 - When it is the assets (and not the defendant) that are located in the jurisdiction of Québec, other remedies may be more attractive: seizures before judgment.
 - But not always; the defendants were not domiciled in Québec when the injunction was issued in the following case:
 - *Cinar et al. v. Weinberg, Panju et al.* JE. 2006-2234

- Disclosure of the defendant's assets by way of an affidavit and possibility of questioning the defendant about his statement of assets in order to find and protect such assets.
- Notification of third parties having control over the assets of the existing injunction (in both Québec and foreign jurisdictions).
- In some situations, the courts ordered the defendant to hand over his passport to prevent him from leaving the country before certain acts were performed.
 - *Cinar et al. v. Weinberg, Panju et al.* JE. 2006-2234: In the implementation of the *Mareva* injunction issued in Québec and matched with a global asset disclosure order, the English judge ordered the defendant to hand over his passport until he had remitted the statement of assets.
 - *Bayer AG v. Winger*, [1986] 1 W.L.R. 497: Foreign resident required not to leave England before disclosing all of his assets based on the order.
 - *Re Oriental Credit Ltd.*, [1988] 1 All E.R. 892: Director of a company under liquidation required not to leave England before the conclusion of his examination by the liquidators.

- How is a *Mareva* type injunction obtained?
 - It is an *ex parte* procedure.
 - Criteria for the issue of the injunction:
 - Solid *prima facie* right: show the basis and details of the claim against the defendant;
 - Irreparable prejudice: show the reasons for the belief that the defendant might remove or dispose of his assets prior to the execution of the final judgment;
 - Balance (preponderance) of inconvenience.
 - The urgency to act must be proven (this criterion is flexible).
- All material facts must be subject to full and frank disclosure.
- Typical example of the use of a *Mareva* order.

***Anton Piller* order**

- This is a Court order allowing certain individuals to enter a specified location to search for the evidence, property or other assets described in the order and to remove the assets in order to safeguard them.
- Purpose: safeguard and preserve the evidence required by the complaining party.
- May serve as a means to establish the existence or discover the status of the defendant's property.
- Hybrid measure - injunction and seizure.
- *Ex parte* motion.
- The burden of proof is on the complaining party:
 - Strong *prima facie* evidence;
 - Risk of serious prejudice without the issuance of the order;
 - Compelling evidence that the defendant has relevant documents and/or objects in his possession;
 - Demonstrate that it is really possible that the defendant could destroy the materials or assets in his possession prior to the normal evidence communication process.

Norwich Pharmacal order

- A *Norwich* order involves a search prior to the beginning of any legal procedures to find the information or documentation needed to support allegations of fraud or theft against a third party.
- Discretionary and *ex parte*.
- Criteria for the issuance of the injunction:
 - Establish that the claim is reasonable or in good faith;
 - Establish that the third party is involved, intentionally or not, in the perpetration of the wrongdoing;
 - Demonstrate that the third party is the only party who has the required information;
 - Establish that the third party may be reimbursed for the costs to which he/she is exposed by disclosing such information;
 - The interest of justice must favour information disclosure.

Typical examples:

- Obtain from a bank the details of amounts of money that have been transferred from a bank account and the destination of such transfers when the available information is to the effect that a certain amount of money was in that account.
- Obtain the identity of an email account user to whom an employee sent confidential information from his workstation when the employer discovers that confidential information has been leaked.

Factors for a successful civil suit for fraud against a fraudster

- Need to act as quickly as possible (in all the targeted jurisdictions)
- Need to seize and/or freeze the evidence and/or assets
- Need to control the information
 - Private investigator
 - Accountant
 - Trustee
 - Informant
- Need to have efficient access to the legal system
 - Coordinating judge
- International cooperation between jurisdictions and prosecutors
- Need to be lucky!



Measures to Help Prevent and React to Fraud

DAVIES

Measures to Help Prevent and React to Fraud



- Although eradicating fraud is impossible, it is possible to reduce the risk that it occurs.
- The measures to be taken depend on the size of the company and the nature of its operations.
- Assess the risk to delimit high-risk areas (with the awareness that fraud occurs most frequently in the Finance Department).
- Conduct audits prior to hiring, especially for key positions (including police record, credit bureau).
- Review employment contracts (whistleblowing, code of conduct).
- Set up a whistleblowing program and reporting mechanism (telephone line, mailbox or any other anonymous way of exposing an irregularity).

Measures to Help Prevent and React to Fraud



- Implement procedures for conducting internal audits and ideally external audits at regular and irregular intervals.
- Subscribe for insurance (protection against embezzlement, dishonesty and theft, liability of directors and officers).
- Clearly identify one or several persons as being responsible for the management of fraud-related risks.
- Consider setting up a Risk Management Committee, in addition to the Audit Committee, one of the key mandates of which is the management of fraud-related risks.
- Learn how to recognize the early signs (excessive overtime, no vacation, atypical behaviour).

Measures to Help Prevent and React to Fraud



- Control banking business (more than one signing officer, breakdown of tasks).
- Use technological tools to detect fraud.
- Set up a clear policy on the use of information technologies by employees and the access to data by employees. Restrict their use for personal reasons. Enforce the application of the policy.
- Management and the Board of Directors must ensure that fraud-related procedures are implemented.
- Implement an action plan in the event of fraud – reaction time is often crucial (investigation process, stakeholders to be contacted, recovery measures, disciplinary measures).



Thank You!

William Brock, Ad. E.
514 841-6438
wbrock@dwpv.com

Marc-André Boutin
514 841-6527
maboutin@dwpv.com



DAVIES