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WIDENING THE NET: METALS REPO FRAUD, RESCISSION AND BRINGING CLAIMS IN TORT

The English Commercial Court has handed down judgment[1] in another metals fraud, this time involving forged warehouse receipts used in contracts for the sale and repurchase of nickel. The case is unusual because having rescinded the contracts in question, the claimant broker sought to recover its losses from a large number of defendants by means of claims in tort, rather than in contract.

The parties

ED & F Man Capital Markets Limited (**the Claimant**) originally brought claims against ten defendants. Several of these settled and so the judgment dealt only with claims against the remaining defendants.

Background

Between May and October 2016, the Claimant entered into a total of 28 purchase contracts with two defendants (the **sellers**) for the purchase of nickel (together, the **Purchase Contracts**). These were intended to constitute the first leg of a repo transaction and were to be performed by delivery of original warehouse receipts. The structure being a repo, it was anticipated that each purchase would be followed by a future sale of the same or equivalent nickel in the usual way.

The warehouse receipts handed to the Claimant were fraudulent copies of the originals, which had in fact been issued to the rightful owner. Unaware of the fraud, the Claimant sold on the warehouse receipts it received to a sub-buyer.

Following discovery that the receipts were forged, the Claimant served notice of rescission of the Purchase Contracts on the sellers on grounds of fraudulent misrepresentation. It then claimed losses amounting to more than USD 284m.

The claims

Since the Claimant had rescinded the Purchase Contracts, it was not able to bring its primary claims in contract because the effect of rescission is to render a contract void from the outset, as though it had never existed. The Claimant's primary claims were therefore in tort and were made not just against the sellers but also against agents and individuals and the rightful owner of the nickel. The claims included:

1. Deceit
2. Unlawful means conspiracy to injure
3. Procuring breach of contract.
4. Knowing receipt
5. Equitable proprietary claims

The Claimant brought an alternative claim for breach of contract, in the event that the Court found the Purchase Contracts had not been rescinded validly.

The judgment

The Court held as a matter of fact that the warehouse receipts were frauds, created by someone who had access to scanned colour copies of the originals. It also found that the rightful owner of the nickel had actual knowledge of

[1] ED&F Man Capital Markets Limited v Come Harvest Limited [2022] EWHC 229 (Comm)

the fraud and that the sellers' agent and one of its directors were both centrally involved in and had actual knowledge of it.

Breach of contract claim

The Court held that the Claimant had validly rescinded the Purchase Contracts on grounds of fraudulent misrepresentation and therefore its breach of contract claim against the sellers must fail. Had the rescission been invalid, the Court indicated that it would have found that the sellers were in breach of contract.

Tortious claims

1. Deceit

The sellers were held liable in the tort of deceit. They had made false express representations to the Claimant within the Purchase Contracts. Both sellers knew the representations to be false and intended the Claimant to rely on them. The Claimant did so and suffered loss as a result.

By sending the forged receipts to the Claimant, the sellers and those acting on their behalf - in this case an agent and a director of the agent - had made false implied representations which caused the Claimant to enter into the Purchase Contracts. They were also liable in deceit.

2. Conspiracy to injure by unlawful means

The Court summarised this tort as follows: "*A conspiracy to injure by unlawful means is actionable where the claimant proves that he has suffered loss or damage as the result of unlawful action taken pursuant to a combination or agreement between the defendant and another person or persons to injure him by unlawful means, whether or not it is the predominant purpose of the defendant to do so*."

In this case, the Claimant contended that there was an agreement, combination or understanding between the rightful owner of the metal and the director of Sampo International Limited (who was acting on behalf of the sellers and their agent), that the rightful owner would:

(a) supply colour scanned copies of the 92 blank-endorsed original warehouse receipts

(b) refer to those copies in correspondence as warehouse receipts (and not copies)

(c) supply documents called "PMA Letters" addressed to the Claimant's sub-buyer, in respect of each of the fraudulent transactions

(d) enter into contracts and issue invoices which purported to be, but were not, for 'repo' contracts

(e) hold the corresponding original warehouse receipts for as long as dictated by the sellers, their agent and its director.

These actions allowed the sellers and their agent to purport to sell the nickel to third party financiers, including the Claimant, using the colour scanned copies.

The owner of the nickel argued that it had no knowledge of the fraud, either actual or "blind eye," and so could not be acting in combination, understanding or agreement with the others. The Court rejected this, holding that the owner had actual knowledge. However, any liability incurred would run only from the date when it acquired such knowledge.

In order to succeed in its claim, the Claimant had to show that the owner of the nickel intended it harm. There was considerable argument during the hearing as to what "intent to harm" meant and, whether that intent had to be directed at the Claimant specifically.

Following a lengthy review of the law, the Court concluded that "*harm to the claimant must be the <u>end</u> sought by the defendant or the <u>means</u> by which the defendant seeks to secure its end rather than merely a <u>foreseeable consequence</u> of its actions*." If harm to the claimant was the necessary consequence of the defendant's actions and the defendant knew this, then it would be considered to have the necessary intent, even though the purpose of its action was not to harm the claimant.

The Court also held that there was no requirement that harm be directed at a specific claimant. This analysis was strengthened by the fact that "blind eye" knowledge was sufficient to establish liability.

In this case, the owner of the nickel knew that the Claimant was the intended target and cooperated with the other defendants in return for substantial fees. It followed that the owner had sought to advance its own business by pursuing a course of conduct which it knew would be injurious to the Claimant. The necessary ingredients for the tort had been established and the owner was found liable.

3. Procuring breach of contract

The Court held that given its findings of fact both that there had been a fraud and that the sellers' agent and its director exercised "*effective practical control*" over the sellers, all the elements of this tort were met and both the agent and the director were liable for inducing or procuring breaches of contract by the sellers.

4. Equitable proprietary claims

As a result of its findings that the Purchase Contracts had been rescinded, the Court held that monies held by the sellers, agents and original owners of the nickel were held on constructive trust for the Claimant.

5. Knowing receipt in breach of trust

The Claimant argued that if the sums held by the sellers were held on constructive trust, when the sellers transferred those sums to the other defendants, they were in breach of their obligations under the trust and the defendants knew this, giving rise to the tort of knowing receipt in breach of trust.

However, since the Claimant had not actually rescinded the Purchase Contracts at the time when the transfer to the other defendants took place, it had to persuade the Court to impose liability on them retroactively. The Court was not persuaded to do so. It found that it is a precondition to the imposition of liability for knowing receipt in breach of trust that there has been a breach of trust. At the time that the monies were transferred by the sellers, the Purchase Contracts remained in place and therefore the trust had not yet been established. Had the monies been transferred after the Purchase Contracts were rescinded, then the claim may have succeeded.

The consequence of this decision is that parties in the same position as the Claimant might instead choose to affirm a fraudulent contract, depending on what remedies are available to them. Clearly the decision as to whether or not to rescind is of vital importance.

HFW comment

The need to be able to verify the authenticity of documents before entering a transaction is both obvious and challenging. The stakes are high: the burden of proof for establishing fraud is a heavy one and the Court was at pains to emphasise that "cogent evidence" was required to do so.

It is also of note that by bringing claims in tort, the Claimant was able to seek recovery from a wider group of defendants. This can be useful in circumstances where a contractual counterparty has already transferred the monies to its agents or other third parties. The findings of liability against the sellers' agent and the original owner of the warehouse receipts, although based on the facts peculiar to this case, are perhaps therefore of particular significance.

For more information, please contact the authors of this alert

SARAH TAYLOR
Partner, London
T +44 (0)20 7264 8102
E sarah.taylor@hfw.com

AMANDA RATHBONE
Professional Support Lawyer, London
T +44 (0)20 7264 8397
E amanda.rathbone@hfw.com

Research conducted by Georgina Suttie, Trainee Solicitor