Supplier payment fraud in Slovakia

Martin Provazník looks at a hypothetical case of supplier payment fraud, and how they are dealt with under the Slovakian law framework

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A supplier payment fraud is basically a situation when the company misleadingly sends money to someone else, not the supplier or when the company pays for non-delivered goods or services. In practice, we see these situations happening repeatedly. As such, we want to provide you with a brief overview of the types of supplier frauds that we see in Slovakia and what can be done from a legal perspective in a subsequent insolvency.

Types of supplier payment fraud

In practice, we see "attacks" coming from three vectors: from a third party, from the supplier or from someone inside the company. Here are some examples:

Third-party fraudster

- Business email compromise. A scammer impersonates a vendor, sends a fraudulent invoice, and tricks an employee into sending payment.
- CEO fraud. Criminals use AI to clone the video or voice of a trusted executive to authorize unauthorized payments. This synthetic voice is used in a call to trick an employee into taking unauthorized actions, such as money transfer.

Inside fraudster

- Fictitious vendor or "shell company." An insider submits invoices for non-existent vendors or undelivered goods, often with external collusion.

Fraudulent supplier

- Overbilling. Vendors inflate invoices for goods or services not delivered or charge more than agreed.

NB. These are just examples and there are also different types of frauds.

Now, from a legal perspective, an interesting situation is if the "victim" – the company – becomes insolvent. Insolvency can happen because or regardless of the fraud. What can the insolvency administrator do? More interestingly, can the company's own management be held liable by the insolvency administrator for failing to implement basic internal controls,

thus breaching their duty of care? To simplify it, we will not analyze the criminal options that are open to the insolvency administrator. This is especially as we see that, in practice, after the perpetrator's conviction, the victim, in this case the insolvent company, is usually referred to civil proceedings.

Legal recourse in insolvency: Obvious options for the Slovak insolvency administrator

If the insolvency administrator can identify the fraudster, which is usually only in cases where the fraudster is a fraudulent insider or fraudulent supplier, the insolvency administrator can file an action for damages (probably against an inside fraudster) or an action for the surrender of any unjust enrichment (probably against a fraudulent supplier).

The statute of limitation in Slovakia for these types of cases will be different for an action for damages and for the action to surrender any unjust enrichment. This also depends on whether the damage/unjust enrichment is being demanded from a natural person, possibly an ex-employee, or from an entrepreneur. The subjective limitation period thus can be two, three or four years, whereas the objective limitation period is always a maximum of 10 years after the scam occurred.

As you see, these types of lawsuits are not very easy from a legal point of view, due to the need to precisely analyze which person against whom the action is to be filed, the type of action to file, the different requirements to be proved at the court and also in view of the different limitation periods that apply. Additionally, it is very likely that it might be hard to prove the fraud itself. On the other hand, insolvency administrators do not pay any court fees in these types of cases and can expect a remuneration of approximately 5-6% of the money recovered for the insolvency estate.

Management liability: alternative option for the Slovak insolvency administrator – Is the management liable for not implementing internal controls?

While such claims are very rare in practice, there is a legal basis for holding management liable for failure to implement basic internal controls. For this scenario, we will use the regulations for a limited liability company, which account for approximately 90% of all registered companies in Slovakia.

According to the Slovak Commercial Code, the managing directors of a Slovak LTD are obliged to perform their duties with professional care and in accordance with the interests of the company and all its shareholders. This is a general obligation of due care. It can be reasonably argued that this obligation includes the responsibility to implement basic internal mechanisms to prevent frauds from happening in a company and to implement control mechanisms to uncover frauds that already happened in the company.

There is currently no universally accepted standard for internal anti-fraud mechanisms in Slovakia, but it can be reasonably argued that no one wants the company "giving money" to fraudsters. Having no mechanisms to prevent fraud is like not locking your bike in a city where bike theft is common. Yes, fraud is common.

In Slovakia, the managing director will not be liable for damages if he proves that he acted with professional care and in good faith in the interests of the company. In cases where the managing director did not implement any mechanisms to prevent frauds from happening, it might be hard to prove that he acted with professional care. Especially, if there was no care at all.

A different situation would be if the company's management provided some mechanisms to prevent and uncover fraud, but these mechanisms were not sufficient, especially because fraud occurred. In this scenario, we would argue that the most important facts would be the number of events of fraud and the amount of money lost. The more events of fraud occurred, and the more money was lost, the more likely that the management did not fulfill their obligations to act with professional care.

The Slovak courts have ruled in the past that the LTD's managing director's requirement to act with professional care is fulfilled if he performs his function with the necessary knowledge. That is in an informed manner, and when making specific decisions, he makes reasonable efforts to use all reasonably available information sources and, on that basis, carefully considers the possible advantages/disadvantages (identifiable risks with a view to minimizing them). Compliance with the obligation to act in an informed manner must be assessed from an ex-ante perspective, i.e., considering the facts that were, could have been, or should have been known to him when making the decision.

The general rule is that the managing directors who have violated their duties during their functions are jointly and severally liable to compensate the company for any damage they have caused.

In cases where a Slovak insolvency administrator is thinking on the possibility of filing such actions, we would recommend to file, rather than not. There are sufficient legal arguments that support this type of action. The Slovak insolvency administrator would pay no court fee for such action, but could expose itself to the risk that in case of defeat he might be obliged to pay the defendant's lawyer's costs. Due to the latter, it is a not an easy decision to make, indeed. ■

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