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Chasing After Fraudsters: The Role of State Fraudulent Transfer Laws

By Gavin Gaukroger and Hal Levenberg

It's a time of turmoil. You have been appointed as receiver of a company that has been operating as a fraudulent enterprise. You have assembled your team, done your due diligence on the receivership entity and potential fraudsters, and efficiently taken control of the real property and offices now belonging to the receivership estate. You have met with employees and managers, some of whom are confused and nervous, and others who may have been "in on" the fraud. You have discovered where the fraudster banked, frozen the bank accounts and begun evaluating the electronic records of the company to trace where the money came from and where it went. You identify the potential asset seizures and recoveries for the benefit of the victims of the fraud and legitimate creditors. After further investigation, you determine that the fraudster has dissipated most of the funds and assets of the enterprise.

As a savvy receiver, you know there are more avenues to recovery than the low-hanging fruit of money in the bank and brokerage accounts, boats, jewelry, cars and real property to be sold. There are numerous potential avenues to recovery, and there are "good" to "ok" to "great" laws out there to help you work to ensure that victims receive some recovery.

In this article, we describe the laws and strategies that a federal equity receiver or state court receiver should take to discharge their duties and help the victims of fraud. We practice in Florida but have endeavored to keep the framework and concepts discussed as general as possible. Much of the subject matter of this article can be applied in most states.

Receivers often utilize the legal tools discussed below to recover funds for the estate. The most common approach to recover funds is to use state statutory fraudulent transfer (also called "fraudulence conveyance") laws. Bankruptcy trustees use similar tools that are specified in the Bankruptcy Code. Because receivers cannot avail themselves of the Code, they typically turn to the laws of the state where the fraud occurred. If assets are located in multiple states, as is common, then the receivers will need to

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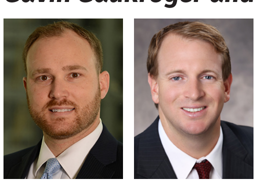

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immerse themselves in the nuances of state law.

Their mission is all the more important now in cases involving the Federal Trade Commission ("FTC") because of a U.S. Supreme Court case in 2021, *AMG Capital Management, LLC v. FTC*, which limited the ability of the FTC to seek restitution for consumers.[1] For years, the FTC had used section 13(b) of its statute to recover monies as well as impose permanent injunctions for deceptive trade practices. The FTC can still seek injunctions under section 13(b) but the Court's ruling said it could not use that section to recover money. As a result, enforcement cases previously brought under this section of the FTC's statute have now been relegated to state court under the various state consumer protection laws, at least for now, until Congress acts to restore the FTC's authority.[2] Meanwhile, the *AMG Capital* decision has shifted responsibility to state Attorneys General and state court receivers to fill the gap. Fortunately, most states retain robust tools to shutdown fraudulent schemes, appoint receivers and recover money for injured consumers and investors, as we describe below.

State Fraudulent Transfer Law

State laws on fraudulent transfers vary. For example, there are eighteen jurisdictions that criminalize fraudulent transfers. In addition, there are civil fraudulent transfer laws in the United States that a receiver can use to recover money for injured consumers or investors:

- The Uniform Fraudulent Transfer Act ("UFTA");
- The Uniform Voidable Transaction Act ("UVTA") a/k/a, the 2014 Revisions to the Uniform Fraudulent Transfer Act, which have been adopted in many states;
- Non-Uniform Fraudulent Transfer Statutes, which are available in a few states such as Alaska, Kansas, Louisiana, South Carolina and Virginia;
- Fraudulent Transfers for U.S. Claims, where the U.S. is a party; and
- Common Law Fraudulent Transfers, which exist in many if not most states.

Common law fraudulent transfers are often pleaded as an alternative cause of action to statutory claims. Common law fraudulent transfer claims usually have a longer statute of limitations than under UFTA or UVTA. In some states, the statute of limitations for a common law fraudulent transfer action does not begin to run until after the creditor obtains a judgment against the debtor.

Receivers in complex, multi-jurisdictional receiverships will want to be mindful of these state laws to ensure that claims are brought timely and pleaded correctly. A receiver appointed in one state may have to apply the laws of several states if assets and transfers are found to have occurred in other jurisdictions. Fortunately, federal courts can empower receivers to act across state borders, wherever assets are located.[3] If the receivership estate owns properties in multiple jurisdictions, a federal equity receiver will want to obtain control of and have the right to sell them as soon as possible. Failure to act quickly can have severe impacts on the value of the receivership estate.[4]

In Florida, for instance, two primary types of fraudulent transfers are addressed by Florida's Uniform Fraudulent Transfer Act ("FUFTA"). One is based on findings of actual fraudulent transfer. The other is through evidence of constructive (implied) fraudulent transfer.[5] When a transfer is made with "actual intent to hinder, delay, or defraud" a creditor – that is actual fraud under FUFTA.[6] The key here is intent. To demonstrate intent, the receiver must be able to demonstrate the transferor's actual intent to commit fraud or seek to rely upon a previous guilty plea or verdict against the principal fraudsters in a related action or from judgments entered in the case brought by a regulatory agency, such as the Securities and Exchange Commission ("SEC") or the FTC.

If the receivership entity has not already been ruled a fraud by a court, a receiver will often submit evidence sufficient to obtain an order from the court. The court order can find that the fraud was a Ponzi scheme or rely on the Ponzi-scheme "presumption." Under the Ponzi-scheme presumption, the mere existence of a Ponzi scheme is sufficient to establish actual intent. Therefore a receiver or trustee is not mandated to undertake an analysis of the badges of fraud but is instead entitled to a presumption of actual intent if he or she proves the existence of a Ponzi scheme. This is usually done through a report, declaration or affidavit from a forensic accountant on the case. This can become more complicated in cases with multiple companies or entities in receivership, and a receiver must analyze whether the transferor was the fraudulent entity that made the payment. A guilty plea or verdict in an underlying criminal case against the fraudster can also give rise to the Ponzi-scheme presumption. In addition, "doctored" or fictitious investor statements are sometimes sufficient to prove actual fraud.

The timing of the Ponzi scheme is critical to bringing constructive fraudulent transfer claims against third parties. Where the enterprise has already been deemed a fraud or a Ponzi scheme, many courts have found:

- a Ponzi scheme is insolvent from its inception;
- an intention to defraud creditors may be inferred from that fact that a debtor is operating a Ponzi scheme; and
- the perpetrator of a Ponzi scheme does not receive "reasonably equivalent value" or good consideration for payments made to investors that are in excess of the investors' capital investment.[7]

These findings make it difficult for net winners – discussed below in more detail – to avoid liability in excess of their initial investment.

Statutes of Limitation

In many cases, a receiver may not be able to determine right away whether and when the fraud was committed. Fortunately, claims of actual fraudulent transfer are often subject to the "delayed discovery" doctrine. In general, a cause of action for actual fraudulent transfer is extinguished unless the action is brought within four years after the transfer was made.

If, however, the statute contains a "savings clause," then a claimant can bring a claim within one year after the transfer was or could reasonably have been *discovered* by the claimant.[8] The savings clause for actual fraudulent transfer claims places the onus on the receiver to establish when the actual fraudulent transfer was discovered and to overcome potential defenses that the fraud could reasonably have been discovered earlier. Findings of fraud by a court in the regulatory action or related criminal cases often aid in establishing actual fraud.

A similar problem arises in pursuing a constructive or implied fraudulent transfer claim, which is usually defined as: 1) a transfer made or obligation incurred by a debtor without receiving reasonably equivalent value in exchange for the transfer or obligation; and 2) the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.[9] In Florida, for example, the FUFTA statute enumerates the possible "badges of fraud" sufficient to help establish that a constructive fraudulent transfer occurred.[10] Similar statutes exist elsewhere. Indeed, the "badges of fraud" concept dates back to 17th century England.

The statute of limitations for avoiding constructive fraudulent transfers is four years in most states, as it is for actual fraud. In other words, a cause of action based on constructive fraudulent transfer is extinguished unless the action is brought within four years of the alleged transfer, regardless of when the transfer is ultimately discovered.[11] In Florida, there is no savings clause under the delayed discovery doctrine for constructive fraudulent transfers, unlike claims for actual fraud.

Net Winners

After your forensic accountant or team has analyzed the bank and brokerage accounts and prepared flow of funds schedules for the receivership estate's bank accounts, you will have a good understanding of the inflows and outflows. Suppose you discover that there are large numbers of people who profited from the fraud as "net winners," insiders or promoters.

First, let's discuss net winners and the legal theories behind recovering monies from them. Simply put, a net winner is an investor who received more money back from the fraud than they put in. Net winners often have to pay back the amounts over and above what they invested (typically total redemptions minus principal investment) and those "net winnings" are used to compensate others who lost money in the fraud ("net losers"). The justification for this approach is that the "net winners," even if innocent of any fraud themselves, should not be permitted to "enjoy an advantage over later investors sucked into the Ponzi scheme who were not so lucky."[12]

Insiders

During your investigation, you may also discover that insiders of the fraudulent company diverted investor money for their own benefit. In those situations, a receiver often brings claims against those insiders to return those funds. Once again, fraudulent transfer theory is one form of recourse against these individuals. The same criteria under actual fraud and constructive fraud apply. The receiver, who stands in the shoes of the entities over which they are appointed, also has claims to clawback funds from insiders, including unjust enrichment, conversion and turnover, if assets are readily traceable from the fraudulent enterprise.

Many insiders in receiverships are also being pursued by regulatory agencies such as the SEC and FTC. Although the receiver must always remain independent and neutral, collaboration between the regulatory agencies and the receiver often benefits the receivership estate, conserves resources and provides for better outcomes for victims of the fraud. Issues such as collectability from insiders and likelihood of success must be considered prior to pursuing causes of action, particularly when the enforcement agency is seeking damages and/or restitution from the same potential defendants.

Third Parties and Wrong Payor Claims

What about third parties that received funds from the perpetrators of a fraud and for which the receivership entity received no value?

These actions, frequently referred to as "wrong payor" causes of action in bankruptcy, are brought against a third party who improperly received funds from the fraudulent entity and for which the receivership estate received no value. Examples include political and charitable contributions. Other examples include expenses incurred by the fraudster for his or her sole benefit. Consider, for instance, a payment by the fraudulent company for the installment of a luxury pool for an insider, paid for with investor monies. What liability does the pool company have for taking monies from the entity? Trustees and receivers should consider whether these transfers constitute constructive fraudulent transfers under the applicable state laws. The pool company profited by installing a luxury pool from the proceeds from a fraudulent investment or Ponzi scheme. With the presumption that a Ponzi scheme is insolvent from its inception, the pool company cannot argue that the transfer was made while the investment company was solvent.

Many defendants of constructive fraudulent transfer complaints argue the good faith defense, and they assert that they provided value to the fraudulent company unknowingly. In Texas, for instance, recipients of fraudulent transfers can defend against clawback actions by proving they received property "in good faith and for a reasonably equivalent value"[13] but they bear the burden of proving that good faith defense.[14] The Texas Supreme Court has not defined "good faith," but Texas lower courts have adopted an objective definition: "A transferee who takes property with knowledge of such facts as would excite the suspicions of a person of ordinary prudence and put him on inquiry of the fraudulent nature of an alleged transfer does not take the property in good faith and is not a bona fide purchaser."[15] In our view, this is generally a subjective test and one that requires an analysis on a case-by-case basis.

Claims Against Promoters

Frauds are often perpetrated and effective because of the actions of promoters or salespeople. These individuals profit by raising funds from investors and are usually paid a lucrative commission for the funds they have raised.

Many receivers sue to recover the commissions paid to the promoters or salespeople under a variety of claims, including unjust enrichment and fraudulent transfer theories. The reasons for these claims may include:

- The commissions to the promoters or salespeople were inherently fraudulent because they were made as part of the scheme;
- The transfers for the payment of commissions were made with actual intent to hinder, delay, or defraud creditors of the receivership entity;

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- The transfers were fraudulent because the receivership entity did not receive reasonably equivalent value in exchange for those transfers, and the receivership entity was insolvent at all relevant times.

In addition, a receiver could bring claims for unjust enrichment against the promoters based on the proposition that the payments to the promoter were inequitable and unjust to the investors who invested because of the promoters' acts. In some cases, the SEC has pursued salespeople and promoters for improper sale of securities.

Claims Against Professionals

Claims against the fraudulent enterprise's law firms and accountants are often brought by a receiver. Breach of fiduciary duty, negligence/gross negligence/professional malpractice, and common law aiding and abetting of fraud are common claims brought against lawyers or accountants who assisted the fraudsters in the perpetration or continuation of the fraud scheme. Receivers with professional liability claims must be mindful of statutes of limitations for claims against professionals. For example, the statute of limitations for filing claims for attorney malpractice in Florida is two years. In other states, it may be longer and involve questions of continuous representation and when the malpractice was committed, compared to when the malpractice was discovered. Receivers and practitioners should be mindful of the regulatory frameworks governing the professionals who advised the perpetrators of the fraud, or who represented the fraudulent enterprise, or who profited handsomely in doing so, justly or unjustly.

Claims Against Banks and Brokerage Firms

Banks and brokerage firms are often potential avenues of recovery for a receiver. Banks that are willfully blind to a fraudulent enterprise may have liability for the damage caused to investors through theories of aider and abettor liability, and in some cases, conspiracy to commit civil torts. Banks repeatedly have defended claims from a receiver or trustee by asserting that they were "mere conduits" with no control over fraudulently-transferred funds while the funds were at their bank. In order to assert a "mere-conduit" defense, however, the bank must prove that it merely acted as a facilitator for the fraudulent enterprise. This defense relies heavily on facts. The parties involved must prove the existence of financial and business relationships and offer documentation and testimony at trial.

Recent Cases from Florida

The authority of receivers to maintain claims against recipients of proceeds from fraudulent enterprises has been a source of litigation in courts across the country for many years. But in Florida, receivers' claims against banks, law firms, accountants, auditors and others who aid and abet fraudsters have been frustrated by recent case law from federal courts. The decisions in *Isaiah v. JPMorgan Chase Bank, N.A.*, 960 F.3d 1296 (11th Cir. 2020)*("Isaiah")* and *Perlman v. PNC Bank, N.A.*, 38 F.4th 899 (11th Cir. 2022)("*Perlman*") have effectively added new pleading requirements for a receiver who files tort claims against third parties. These opinions have added a required showing that the company in receivership was an honest corporation, not solely an entity through which frauds were committed.[16] Although the holdings were specific to the Florida statute, receivers and their counsel are well advised to pay attention to this issue no matter where they practice.

At issue in the *Perlman* decision was whether the receiver had to establish the existence of an innocent director or stockholder in the entity prior to the receivers' appointment. "[U]nless the corporation in receivership has as at least one honest member of the board of directors or an innocent stockholder, the fraud and intentional torts of the insiders cannot be separated from those of the corporation itself and the corporation cannot be said to be an entity separate and distinct from the individual tortfeasors," the court held, quoting from its *Isaiah* holding.[17]

We believe the *Perlman* decision has taken away necessary tools from a receiver's tool belt in Florida. In our view, the majority opinion in *Perlman* is inconsistent with the underlying purposes, statutory language and public policy behind the receivership process – to stop fraudulent operations and recover assets for receivership estates, and ultimately victims of fraud schemes.

The dissent in *Perlman* persuasively argued that the court's decision was inconsistent with the amendments to the Florida Deception and Unfair Trade Practices Act in 2006, enacted after the decision in *Freeman v. Dean Witter Reynolds, Inc*., 865 So. 2d 543, 550 (Fla. 2d DCA 2003), which gave back to receivers in Florida the right to bring claims and to "ensure that a receiver acting on behalf of a former alter-ego corporation had standing to pursue claims against third parties who allegedly aided and abetted the former alter-ego corporation in carrying out its intentional torts."[18]

In our view, the dissent got it right. For decades, a receiver of newly "cleansed" receivership entities could assert claims for undue enrichment against the "evil zombie" management of the company that wrongfully dissipated funds from receivership entities.[19] Moreover, receivers have long been protected from the equitable defense of *in pari delicto*," which is used to deny relief because of equal wrongdoing by both the plaintiff and the defendant.[20]

In many jurisdictions, the *in pari delicto* defense can be overcome by showing the existence of at least one innocent director, shareholder or insider with power to influence the entity's conduct. In other instances, the appointment of a receiver alone is sufficient to vitiate the defense. Unfortunately, the decision in *Perlman* seems to flip these concepts on their head by importing elements from the defense into the receiver's initial burden of establishing a claim.

In our opinion, if a receiver displaces the "evil zombies" who managed a fraudulent enterprise, the receiver should be protected from the equitable defense of *in pari delicto*. The additional requirement of establishing at least one innocent director or shareholder should be irrelevant to the question of the receiver's standing to bring tort claims on behalf of a receivership estate. When the receivership estate suffered injuries at the hands of the "evil zombies" who aided and abetted the fraudsters, the receiver should be free to recover and distribute funds to victims of the fraudsters' conduct.

The Eleventh Circuit's holding in *Isaiah* and *Perlman* do not reconcile these distinctions. Instead, they hold that "it is 'not the corporation but the individual customers who suffered injury as a result of the [fraudulent] scheme, and who may have rights to pursue claims against third parties that allegedly aided and abetted that scheme.'"[21] For now, many tort claims a receiver previously held (at least in the Eleventh Circuit) may have to be relegated to the class action bar, which has its own challenges beyond the scope of this article.

Conclusion

In the ever-changing landscape of receiver appointments and case law, receivers and their counsel should be mindful of the tools in their toolbelts and continue to make every effort to recover for the victims of frauds.

ENDNOTES

1 *AMG Capital Mgmt., LLC v. FTC*, 141 S.Sct.1341 (2021). For an analysis of the case, See Kevin Duff, "The *AMG Capital* Decision and Its Impact on FTC Enforcement," *The Receiver*, Issue 12, July 2021.

2 On April 22, 2021, the U.S. Supreme Court held in *AMG Capital* that the authority to obtain injunctive relief under Section 13(b), 87 Stat. 592, 15 U.S.C. § 53 (b), does not include the right to obtain equitable monetary relief, such as restitution or disgorgement.

3 *See* 28 U.S.C. § 3103(b); 28 U.S.C. § 754.

4 A federal equity receiver must act fast to preserve property in other states and file copies of the complaint and the order appointing the receiver "in each district court for each district in which property is located." 28 U.S.C. § 754. The statute provides: "The failure to file such copies in any district shall divest the receiver of jurisdiction and control over all such property in that district." *Id.*

5 The UFTA is referred to as "TUFTA" in Texas, for example, and has similar acronyms in other states which have adopted the UFTA standards.

6 Section 726.105 (FUFTA).

7 *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 462 (Bankr. S.D.N.Y. 2015) (noting that "every circuit court to address this issue has concluded that an investor's profits from a Ponzi scheme are not 'for value.'") (citations and internal quotations omitted).

8 *See* § 726.110(1) (FUFTA).

9 See § 726.106 (FUFTA).

10 *See* § 726.105(2) (FUFTA).

11 *See* § 726.110(2) (FUFTA).

12 *In re United Energy Corp*., 944 F.2d 589, 596 (9th Cir.1991).

13 *See* Tex. Bus. & Comm. Code § 24.009(a).

14 *Hahn v. Love*, 321 S.W. 3d 517, 526 (Tex. App. – Houston [1st Dist.] 2009, pet. denied); *see also GE Capital Commercial Inc. v. Worthington Nat'l Bank*, 754 F.3d 297, 313 (5th Cir. 2014) (citing the "good faith" test articulated in *Hahn*).

15 *Hahn*, 321 S.W. 3d at 527 (citations omitted).

16 *Perlman v. PNC Bank, N.A.*, 38 F.4th 899, 904 (11th Cir. 2022)("*Perlman*"). The "axiomatic" principle from *Isaiah v. JP MorganChase Bank, N.A.*, 960 F.3d 1296 (11th Cir. 2020)("*Isaiah*") is "that a receiver obtains only the rights of action and remedies that were possessed by the person or corporation in receivership." *Id.* at 1306. If the corporation in receivership is one that is operated for the sole purpose of committing fraud, and thus not an "honest corporation," then that corporation "cannot be said to have suffered an injury from the scheme it perpetrated." *Id.* at 1306. Since the receiver "obtains only the rights of actions and remedies" of the corporation in receivership, it follows that the receiver likewise would not have suffered an injury for purposes of bringing such claims.

17 *Perlman* at 903-904.

18 *Perlman* at 908 (J. Rosenbaum, dissent).

19 *Id.*

20 *Pinter v. Dahl,* 486 U.S. 622, 632, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988); *see Official Cmte. of Unsecured Creditors of PSA, Inc. v. Edwards,* 437 F.3d 1145, 1152 (11th Cir. 2006) ("The doctrine of *in pari delicto* is an equitable doctrine that states 'a plaintiff who has participated in wrongdoing may not recover damages resulting from the wrongdoing.'") (quoting Black's Law Dictionary 794 (7th ed.1999)). Nearly thirty years ago, in the seminal case *Scholes v. Lehmann,* 56 F.3d 750, 754 (7th Cir. 1995) the Seventh Circuit rejected the notion that a receiver could stand *in pari delicto* with defendants. 56 F.3d at 754. The court reasoned that the appointment of a receiver displaces the managers who had engaged in the wrongful conduct, and thus ensures that any recovery would go to the receiver and ultimately the innocent creditors, rather than the wrongdoers. *Scholes,* 56 F.3 d at 754–55. That is, "the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated." *Scholes,* 56 F.3d at 754–55. While the defense has been asserted effectively against trustees in bankruptcy cases, "it usually does not apply in cases involving court-appointed receivers." *Id*. at 754; *see also F.D.I.C. v. O'Melveny v. Myers,* 61 F.3d 17 (9th Cir. 1995); *Hannover Corp. of Am. v. Beckner,* 211 B.R. 849 (M.D.La. 1997).

21 *Perlman* at 904 (quoting *Isaiah*, 960 F.3d at 1306).