

Role of the Financial Advisor in Ponzi Schemes

Moderator: Peggy Hunt, Esq.
Partner, Dorsey & Whitney LLP

Speakers: Harvey Sender, Esq.
Partner, Sender Wasserman Wadsworth PC

D. Ray Strong, CPA, CFE, CIRA
Director, Berkeley Research Group LLC

R. Todd Neilson, CPA
Director, Berkeley Research Group LLC

What Creditors and Investors Want to Know

- **What happened to my investment? Show me the money!**
- **When will I get paid?**
- **Are the promoters going to jail?**



Is It A Ponzi Scheme?



Is It A Ponzi Scheme?

- **Factual and legal characteristics of a Ponzi scheme – Court looks for a general pattern, rather than specific requirements, but generally, the following factors are considered:**
 - Use of new investor funds to pay older investor returns and obligations.
 - Overly consistent returns until a specific point in time.
 - Faith, trust, and confidence in Promoter.
 - Religious or social affiliation, creating an “affinity” or false trust.
 - Unregistered investments and/or unlicensed sellers.
 - False and fraudulent financial statements and representations.
 - Reliance on outside funding.
 - Under capitalization of the enterprise.
 - Pooled investor cash and use of cash by numerous enterprises through intercompany transfers and/or as part of a single piggy bank.

Is It A Ponzi Scheme?

- **Factual and legal characteristics of a Ponzi scheme – Court looks for a general pattern, rather than specific requirements, but generally, the following factors are considered: (continued)**
 - Need for an ever-increasing supply of new funding.
 - Attrition or disappearance of a profitable product, investment, or service sufficient to pay promised returns or obligations.
 - Typically involves a hook such as high investment returns with little or no risk but due to the recent unavailability of any meaningful interest returns from financial institutions, many recent Ponzi schemes offer returns that are only moderately higher than average.
 - Secretive, convoluted and/or complex strategies.
 - Use of numerous entities and investment vehicles.
 - May have started as a legitimate business that transformed to a Ponzi.
 - Will eventually collapse.

Is It A Ponzi Scheme?

■ Importance of the Ponzi Finding

- Typically one of the largest assets of a bankruptcy or receivership estate involving a Ponzi enterprise are clawback actions against “net winners” (see below) – i.e., requiring the net winners to return the portion of money they received from the fraud over and above the amount paid in as an investment.
- Obtaining a ruling of the court that an enterprise is a Ponzi is important for creating the “Ponzi” presumption—under the Uniform Fraudulent Transfer Act (UFTA) and Bankruptcy Code § 548, a receiver or trustee can recover amounts transferred by the enterprise if transfers are made with “actual intent to hinder, delay or defraud creditors” – if the enterprise is a Ponzi, the mere existence of a Ponzi is sufficient to establish actual intent to hinder, delay or defraud. Once this presumption is established the burden shifts and the defendant has the burden of establishing a defense.

Is It A Ponzi Scheme?

- **Importance of the Ponzi Finding (continued)**
 - Obtaining a ruling of the Court that an enterprise is a Ponzi is also important because it limits the recovery allowed to investors—no investor can recover interest owed under the investment vehicle, but only a recovery limited to their principal investment.
 - Many Ponzi enterprises start as a legitimate business and morph into Ponzis. Thus, for purposes of determining the date from which monies can be recovered or “clawed back” it is important to pinpoint when the enterprise began to operate as a Ponzi scheme.
 - Identifying an enterprise as a Ponzi may also be important for purposes of coordination and cooperation with state or federal agencies.

Is It A Ponzi Scheme?

■ Issues In Proving It's A Ponzi

- When did the scheme begin?
- No real business activity or ongoing operations are not self-sustaining.
- Reliance on outside funding to continue scheme.
- Investor monies were not used for stated purpose.
 - Used to pay other investors.
 - Used to make other non-disclosed or high risk investments.
 - Used to Line the pockets of the Promoter.
- Deepening insolvency.
 - Ponzi schemes by their nature are insolvent and continue to deepen their insolvency as time goes on.
- Transferor's Intent vs. Reasonably Equivalent Value.
- Expensive and time consuming endeavor.
- Prove it's a fraudulent activity.

Investigation



Investigation

- **Locate, Inventory And Organize Hard Copy And Electronic Records**
 - Budget issues/constraints
 - Spending the time and money upfront will save you far more in the end, ***but***
 - Liquid assets are frequently limited at the beginning of the case.
 - Assists with understanding what information you have, what is still needed, and provides a jump start to the analysis.
 - Computer forensics and/or electronic discovery
 - Inventory/Document Management System
 - Word/Excel/Access
 - Electronic Document Management System

Investigation

- **Correlate With Federal Or State Criminal Investigation**
 - Often can coordinate and use powers of DOJ to seize assets.
 - Occasionally, if few funds exist for administration, can fold investigation and assets into criminal grand jury investigation and incorporate findings into restitution orders.
 - Conflict issues may arise between the criminal and civil proceedings, in that the victims for the criminal indictment may not directly correlate with the victims in the civil proceedings. In addition, Grand Jury subpoenaed documents are privileged.
 - Depends on the size and complexity of the case as well as the assets available to fund the investigation and provide a meaningful pay out to investors.
 - Finally, if the only way administrative fees are going to be paid is to sue and collect fraudulent conveyances from “net winners,” the route is complicated in the 10th circuit. The legal claims that are available to a receivership estate, and available defenses, can be materially different from those that are available to a bankruptcy trustee. The statute of limitations for bringing claims are different as well.

Investigation

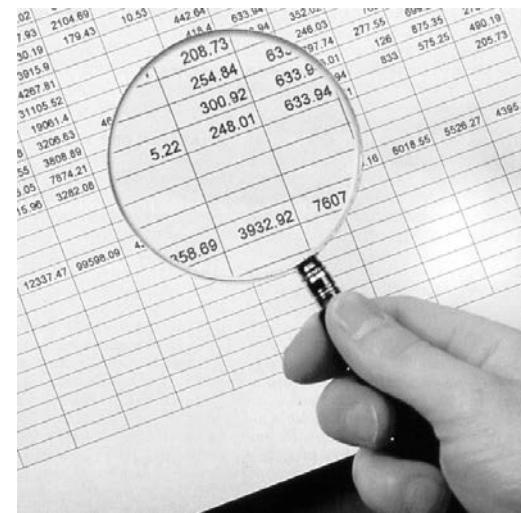
■ Cash Receipts And Disbursements Reconstruction

- Cash is king! Follow the cash.
- Obtaining bank records
 - Bank statements
 - Wire transfer confirmations
 - Debit and credit memos
 - Deposit slips and underlying checks
 - Canceled checks
- Identify and locate accounting system(s) data files
- Extract accounting system data into a database
- Create cash database
 - Understand the potential size of data and number of transactions to determine database software to utilize.
- Utilize data extractions from accounting system(s)



Investigation

- **Cash Receipts And Disbursements Reconstruction (continued)**
 - Analyze and compare accounting system extractions to bank/broker documentation.
 - Beware of falsified documentation – Compare to documentation and information obtained directly from banks/brokerage accounts.
 - Identified required tables and fields in database
 - Every case is different with its own unique issues
 - Tables
 - Transaction Detail
 - Bank/brokerage accounts
 - Classification/Category
 - Payor/Investor
 - Payee/Vendor
 - Entity



Investigation

- **Cash Receipts And Disbursements Reconstruction (continued)**
 - Transaction Detail Fields
 - Transaction Date
 - Bank Clear Date
 - Reference # or ID
 - Bank Account ID
 - Entity ID
 - Payor/Payee
 - Amount
 - Transaction Total (If transaction is split)
 - Transaction Description/Memo
 - Classification/Category
 - Accounting System Memo
 - Accounting System General Ledger Account
 - Workpaper Reference
 - Workpaper Link (If linking workpapers to database)



Investigation

- **Cash Receipts And Disbursements Reconstruction (continued)**
 - Reconcile activity to bank/brokerage statements and documentation
 - Add clear dates and additional transactions
 - Analyze company and third-party documentation, information and data to populate or accurately reflect transaction information
 - Classify or categorize transactions
 - Create detailed working files/work papers



Investigation

- **Addressing Multiple Entities And Bank Accounts Involved**
 - Identifying related entities and related bank/brokerage accounts
 - Company records
 - Corporate entity searches (TLO, Lexis Nexis, State searches)
 - Interviews of employees and promoters (if possible)
 - Obtain tax returns
 - Cooperative investors
 - 2004 Examinations/Subpoenas
 - Create entity, account, and classification tables and coding system



Investigation

■ Transaction Classification

- Identify and analyze transaction documentation
 - Bank documentation
 - Company records
 - Accounting system(s)
 - Investor tracking system(s)
 - Third party documentation
 - Investors
 - Vendors
 - Sellers of Acquired Assets/investments
 - Title Companies
 - Investigative database searches
 - 2004 Examination/Subpoena of promoters/management/employees



Investigation

- **Transaction Classification (continued)**
 - Legitimate operating income and business expenses
 - Investor and funding sources
 - Principal investments
 - Loan activity
 - Interest payments
 - Redemptions
 - Asset investment and acquisition activity
 - Inter-company and intra-company activity
 - Misappropriations and personal expenses



Investigation

- **Summarize Sources And Uses Of Cash**
 - By Category/By Year
 - By Category/By Month
- **Ability To Create Various Detailed Transaction Reports/Queries**
 - Assist in demonstrating Ponzi
 - Cash tracing to locate other assets and recoveries
 - Assist in dealing with cash tracing issues
 - Quantify misappropriations and personal expenses
 - Assist in analyzing preferences and fraudulent transfers
 - Assist in analyzing claims
 - Assist in preparing tax returns (possible tax refunds)
 - Research tool for other causes of action and inquiries
 - Who to sue and not to sue

Litigation and Legal Standards

- **Nature of Claims** – Receivers and trustees are charged with maximizing the assets of the estate and minimizing expense so as to make a meaningful return to those who lost money on the principal investment made (i.e., “Net Losers” discussed below). In so doing, one of the largest assets to be obtained in a Ponzi enterprise is funds paid to “Net Winners” (see below). Thus, most litigation in Ponzi cases are “claw back” or avoidance actions, but there may be claims to be made against those who aided and abetted the scheme (i.e., professionals), who owe money to the enterprise as a result of loans or gratuitous transfers made by the Promoter, or based on monies paid from investor funds on debts owed, not by the enterprise, but by the Promoter individually.



Litigation and Legal Standards

- **In Pari Delicto** — This defense applies to non-claw back actions—typically claims against professionals or others who are alleged to have allowed the fraud to continue. Generally, it prohibits one who has done wrong to recover from another wrongdoer. So, if the trustee or receiver “stands in the shoes” of the wrongdoer in bringing claims, he or she may find that in pari delicto bars claims against others who may have allowed the fraud to be committed. This defense does not apply to preference and fraudulent transfer actions discussed below because those are actions in which the trustee or receiver is not standing in the shoes of the fraudulent enterprise, but rather is bringing claims as a court appointed fiduciary or because he or she is standing in the shoes of creditors. Some courts have held that this defense never applies to a receiver, but the defense has been held to apply to bankruptcy trustees.



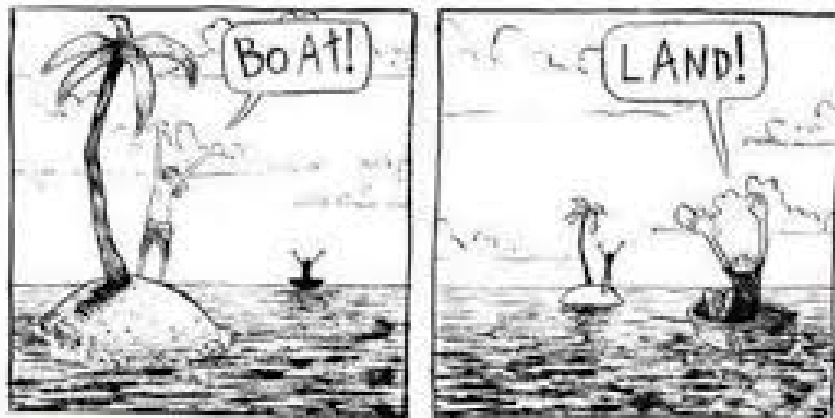
Litigation and Legal Standards

- **Investors Generally Fall Into Two Categories:**
 - Net Winners – Investors who received payments for promised returns and/or redemptions in excess of their initial principal investment.
 - Net Losers – Investors whose funds were used to satisfy earlier investor payments, operating expenses, or lavish lifestyles of the promoters and were not paid back their initial principal investment prior to schemes failure.
 - These categories encompass individual investors as well as “feeder funds” such as hedge funds, institutional investors, banks, brokerages, or larger pools of other investors.



Litigation and Legal Standards

- **Perspectives:** There are different agendas that a court-appointed fiduciary faces depending on whether the investor is a Net Winner or Net Loser:
 - Net Winners typically do everything they can to protect the returns and redemptions paid to them.
 - Net Losers desperately trying to recover something from their investment and the fiduciary is charged with obtaining this recovery for them.



Perspective...

Litigation and Legal Standards

■ Recovery Tools

■ Preferential Transfers

- Lower burden of proof
- Allows recovery of assets transferred on account of an antecedent debt within 90-days of the filing of a bankruptcy petition or 1 year in the case of transfers made to insiders.
- Typically, recovery of preferential transfers only exists under Bankruptcy Code section 547(b), but some states also have laws with preference-type remedies.
- Typical bankruptcy defenses
 - Ordinary Course
 - New Value
 - Contemporaneous Exchange
- Defenses lose merit in Ponzi schemes because “ordinary course” can’t facilitate a fraud.
- Typically most, if not all, of the transactions in a Ponzi scheme are outside the 90-day/1 year window.

Litigation and Legal Standards

- **Recovery Tools (continued)**

- Fraudulent Transfers

- Bankruptcy vs State Fraudulent Transfer Actions

- Look-back is 2 years from petition date.

- State Actions (UFTA)

- Look-back typically 4 years in most states and can be 6 years in some states.



Litigation and Legal Standards

■ Recovery Tools (continued)

■ Fraudulent Transfers

- Must prove Intent or No Reasonably Equivalent Value While Insolvent.
 - The transferor's actual or constructive intent was to "hinder, delay, or defraud" creditors—by proving a Ponzi, the receiver or trustee obtains a presumption that this provision is met.
 - The transferor made the transfer while financially distressed and did not receive reasonably equivalent value.



Litigation and Legal Standards

■ Recovery Tools (continued)

- Must prove two assertions:
 - Received less than reasonably equivalent value
 - One of four events
 - ❖ Insolvent on the date of the payout or was rendered insolvent as a result of the payout.
 - ❖ Unreasonably small capital
 - ❖ Intended to incur debts beyond its ability to pay them
 - ❖ Transfer made to or for the benefit of an insider under a separate agreement and not in the ordinary course of business
- Good Faith Defense
 - Value – Transferee gave value for the transfer.
 - Good Faith – Transfer was made in good faith.
 - Objective Good Faith
 - ❖ Inquiry Notice
 - ❖ Diligent Inquiry
 - Subjective Good Faith

Other Not Quite as Glamorous, but Essential, Roles of the Financial Advisor

- Analyzing and Quantifying Claims
- Claims Distributions and Tracking
- Asset Identification/Recovery
- Asset/Investment Valuation Issues
- Operational Evaluations/Services of Assets/Investments
- Tax Compliance and Planning
- Other Litigation/Claims Analysis
- Court Reporting (Financial/Status Reports)
- General Accounting and Administration
- Website Maintenance
- Investor/Claimant Relations





Peggy Hunt
Partner
Dorsey & Whitney LLP
Kearns Building
136 South Main Street Suite 1000
Salt Lake City, UT 84101-1685
(801) 933-8947 : phone
(801) 933-7373 : fax
hunt.peggy@dorsey.com

Experience

Peggy Hunt has extensive trial and appellate court experience in matters related to bankruptcy, receiverships, Ponzi cases, and debtor/creditor rights. Ms. Hunt serves on the Panel of Chapter 7 Trustees for the District of Utah. Additionally, Ms. Hunt regularly represents debtors, Chapter 11 trustees, creditors and equity holders in complex bankruptcy cases, and receivers and creditors in SEC enforcement actions.

Ms. Hunt has been honored as one of the Best Lawyers in America in Bankruptcy and Creditor-Debtor Rights Law. She has also been selected as one of Utah's "Legal Elite" in the categories of Bankruptcy/Creditor Rights Law and Corporate Law (Utah Business Magazine). Peggy often participates in presentations on bankruptcy, receivership and creditor rights law and she serves as a Contributing Author for the Collier Bankruptcy Practice Guide .

Clerkship

Supreme Court of Connecticut, Hon. Robert J. Callahan (1988 - 1989)
United States Bankruptcy Court for the District of Utah, Hon. Glen E. Clark (1989 - 1991)
United States Bankruptcy Appellate Panel of the Tenth Circuit (1996 - 2005)

Admissions

- Massachusetts
- Utah
- The Fifth, Ninth, and Tenth Circuit Court of Appeals

Honors

- Listed in *Best Lawyers in America*
- Named to Utah's Legal Elite (Utah Business Magazine)
- *Pro Bono* Attorney of the Year, Utah State Bar, 1996

Education

University of Pittsburgh School of Law
J.D., 1988
Head Notes and Comments Editor, *University of Pittsburgh Law Review*, 1987-1988

Washington and Jefferson College
B.A., Economics and Political Science, 1985

Professional Activities

- Local Rules Committee, United States Bankruptcy Court, District of Utah
- President-Elect, Utah Chapter of the Federal Bar Association
- Chair, Leadership Committee, And Justice for All
- Founding Member, Mountain/Desert Network (Utah, Colorado, Arizona, Nevada) of the International Women's Insolvency and Restructuring Confederation
- Member, Education Committee, 2014 TMA Western Regional Conference
- Member, Women Lawyers of Utah
- Member, American Bankruptcy Institute
- Member, Turnaround Management Association
- Member, Salt Lake County Bar Association
- Past-President and ex officio member of the Utah State Bar Commission for the Women Lawyers of Utah, 2008 - 2010
- Member, Selected Professions Fellowships Award Panel of the American Association of University of Women, 1998 - 2001
- Chair, Delivery of Legal Services Committee of the Utah State Bar 1997 - 1998
- Chair, Bankruptcy Section of the Utah State Bar, 1995 - 1996
- Board of Trustees, Utah Bankruptcy Lawyers' Forum, Inc., 1993 - 1997

Civic and Community Activities

- Associates Board, Utah Museum of Natural History
- Co-Founder and Chair, Women's Giving Circle for the Community Foundation of Utah
- Member, Utah Women's Forum
- Past-President, Board of Directors, The Sharing Place, Inc.



R. Todd Neilson, Director

2049 Century Park East, Suite 2525
Los Angeles, California 90067
Direct: 310.499-4934
Fax: 310.557-8982
Email: tneilson@brg-expert.com

Summary

R. Todd Neilson is currently a Director at Berkeley Research Group LLC. Previously, Mr. Neilson was a Director with LECG LLC and was a founding partner of Neilson Elggren LLP (formerly Neilson, Elggren, Durkin & Co.). He is one of the nation's foremost experts in bankruptcy and forensic accounting with over thirty five years combined experience in public accounting and as a Special Agent with the FBI.

In 1986, he was a founding partner of Neilson, Elggren, Durkin and Co., which was acquired by an international financial consulting firm in March 1998, where Mr. Neilson was a partner from March 1998 to September 2000. Prior to 1986, he was a manager in the Litigation/Consulting Services department of the international CPA firm of KMG/Main Hurdman for four years and also served as a special agent in the Federal Bureau of Investigation, specializing in accounting investigation of white-collar and organized crime. Due to his background, Mr. Neilson offers a unique set of skills in the areas of financial consulting and as an expert in the field of forensic accounting and fraud litigation.

Mr. Neilson is a seasoned professional having acted as a Trustee, financial consultant and expert witness in numerous high-profile accounting related litigation engagements involving complex bankruptcy reorganization matters including accounting and fraud issues, tracing of funds, financial data reconstruction, damages and lost profits, Ponzi and RICO matters, valuation, and business viability issues. Mr. Neilson has acted as bankruptcy Trustee for notable clients such as Mike Tyson, Suge Knight and Death Row Records. As Trustee, he has also operated, and negotiated the sale of an extremely large and diverse array of assets, including one of the largest Ford dealerships in the nation, an ownership interest in both the Los Angeles Kings' and Nashville Predators' hockey franchises, luxury hotels, sand and rock quarries, antique art collections, real estate, and trucking companies. Having evaluated and sold well over \$1 billion dollars of assets, Mr. Neilson brings substantial credibility to the court - credibility borne of practical, not just theoretical experience.

Mr. Neilson is a nationally recognized expert in bankruptcy and accounting having served on the national Board of Directors of the Association of Insolvency and Restructuring Advisors, Chairman of the Securities Advisory Board in the State of Utah, faculty for the Certified Fraud Examiners, and a member of the Society of the Former Special Agents of the Federal Bureau of Investigation. He has spoken on bankruptcy, litigation support, valuation and fraud related topics to numerous professional groups such as American Institute of Certified Public Accountants (AICPA), National Conference of Bankruptcy Judges, California and Utah Society of CPA's and numerous colleges and universities throughout the United States. Mr. Neilson formerly served as an Associate Professor in the Graduate School of Accounting at the University of Utah, where he taught courses on Forensic Accounting. He has also provided regular instruction on accounting and fraud related litigation issues at the FBI Academy to CPA/FBI Agents and to Postal Inspectors at the United States Postal Service national training center. He was a co-author of the *AICPA Bankruptcy Practice Guide*, issued as a practice aid to all CPA's in the United States and co-author of *The CPA's Handbook of Fraud and Commercial Crime Prevention*, also issued by the AICPA. He was also inducted as a fellow in the prestigious American College of Bankruptcy, one of only a handful of CPA's in the United States given that honor.

HARVEY SENDER

Shareholder

Bankruptcy Litigation
Bankruptcy
Commercial Litigation
Collections

Harvey Sender is a shareholder with Sender Wasserman Wadsworth, P.C. Specializing in bankruptcy and commercial litigation, his practice in this area has been extensive since the mid 1970's and includes wide-ranging experience in Chapter 7 and 11 Trustee issues. He has been appointed as Trustee or Receiver in numerous fraud and Ponzi Scheme cases. He has represented numerous companies as Debtors-In-Possession in Chapter 11, as well as various Unsecured Creditors Committees in both bankruptcy issues and complex bankruptcy litigation involving valuation and confirmation issues. He has been qualified as an expert before various courts in the areas of bankruptcy law and reasonableness of attorneys fees.

Mr. Sender has served as Chapter 7 Trustee for in excess of 35,000 cases. Since 1984, Mr. Sender has served as the Panel Trustee for the U.S. Bankruptcy Trustee Panel. He has also served as a Chapter 11 Trustee on several occasions.

In addition to being a member of the State Bar of Colorado, Mr. Sender is admitted to the State Bar and U.S. District Court of New Mexico and the U.S. District Court for the District of Colorado, the Tenth Circuit Court of Appeals, and the United States Supreme Court. He is also a member of the Colorado Bar Association, New Mexico State Bar Association and the Commercial Law League of America.

Mr. Sender received his B.A. *cum laude* from New York University in 1972 and his Juris Doctorate from Georgetown University School of Law in 1975.

SENDER WASSERMAN WADSWORTH, P.C.
1660 Lincoln Street, Suite 2200
Denver, Colorado 80264
(303) 296-1999

D. Ray Strong, CPA, CFE, CIRA
Director, Berkeley Research Group LLC

Mr. Strong is a Certified Public Accountant, Certified Fraud Examiner, and Certified Insolvency and Restructuring Advisor with more than 18 years of experience providing investigative accounting, bankruptcy, and litigation services.

Mr. Strong has been involved in numerous bankruptcy and insolvency matters including court appointments as bankruptcy trustee, estate manager, examiner, and receiver. He has also provided various financial advisory services to creditors' committees, debtor-in-possession, Chapter 11 and Chapter 7 bankruptcy trustees, and federal and state appointed receivers.

Mr. Strong has provided civil and criminal expert testimony, litigation support, or forensic accounting services, involving the investigation of fraud and mismanagement, tracing of funds, partner disputes, lost-profit damage analyses, breach of contract damage analyses, economic analyses, and insurance claims. He has extensive training and experience investigating fraud and mismanagement including financial statement fraud, embezzlement, Ponzi schemes, check kiting, bank fraud, bankruptcy fraud, inventory schemes, and payroll schemes.

Mr. Strong is currently an instructor at the David Eccles School of Business at the University of Utah where he co-teaches a fraud and forensic accounting course to graduate level accounting students. He has also conducted presentations and seminars relating to various fraud, bankruptcy, and accounting topics.