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# CLAWING BACK GAINS FROM PONZI SCHEMES: A VITAL EXAMINATION OF PONZI SCHEMES, CLAWBACKS, AND THE PONZI SCHEME PRESUMPTION

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## *I. INTRODUCTION*

Ponzi schemes involve the "fantasy that growth can continue at a consistent rate indefinitely."[1] These fraudulent schemes invariably collapse.[2] The very nature of a Ponzi scheme

1. JACOB WREN, RICH AND POOR 14 (Malcolm Sutton ed., 2016).
2. *SEC Enforcement Actions Against Ponzi Schemes*, U.S. SEC. & EXCH. COMM'N., https://www.sec.gov/spotlight/enf-actions-ponzi.shtml (last modified July 11, 2019).

induces its downfall. Thousands are left scratching their heads wondering what occurred with their promising investments. These hoodwinked investors realize that their funds—at times, life savings—entrusted to financiers were merely redistributed to pay similarly deceived investors. And, in a world revolving around just causes, these investors expect some restitution.[3]

More than a hundred years after the first Ponzi scheme, the practice is still alive and well.[4] Ponzi has elevated himself over the years, becoming a household name, as millions recognize the prevalence of the dubious scheme. The focus oftentimes is on the losing investors—those who had a negative return on investment—while dodging the discussion on the winning investors. The designation as a "winning" investor may only last so long. Once the company running the Ponzi scheme faces financial insolvency, it may file for bankruptcy protection.[5] Oftentimes, however, these schemes are exposed before an opportunity to file for voluntary bankruptcy arises, paving the way for the Securities Investor Protection Corporation ("SIPC") to insert a receiver or trustee using the Securities Investor Protection Act ("SIPA").[6]

Luckily for some, unfortunately for others, the Bankruptcy Code (the "Code") contains provisions to level the playing field amongst the winners and losers.[7] To be sure, the SIPA-appointed receiver or trustee who usually facilitates the involuntary bankruptcy and liquidation proceedings is directed to recover funds from the winners for aggregation into the SIPC Fund (the "Fund") and the general estate.[8] The Fund is then used to compensate those with losses from fraudulent activity.[9] As with

3. *See* Donell v. Kowell, 533 F.3d 762, 772 (9th Cir. 2008).

4. Cunningham v. Brown, 265 U.S. 1, 7 (1924) (noting that Charles Ponzi's scheme began in December 1919). Ponzi schemes are investment scams where early investors are paid with money invested by later investors, creating an "illusion of big profits." James Chen, *Ponzi Scheme: Definition, Examples, and Origins*, INVESTOPEDIA, https://www.investopedia.com/terms/p/ponzischeme.asp (last updated June 10, 2024).

5. *See, e.g.*, *In re* Maui Indus. Loan & Fin. Co., 573 B.R. 242, 244 (Bankr. D. Haw. 2017).

6. Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 531 B.R. 439, 449 (Bankr. S.D.N.Y. 2015).

7. Securities Investor Protection Act of 1970, 15 U.S.C. § 78fff(b).

8. Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 499 B.R. 416, 420 (Bankr. S.D.N.Y. 2013).

9. *Id.*

the typical bankruptcy, the bankruptcy trustee is the designated housekeeper. Simply put, the trustee's role in bankruptcy concerns paying back creditors fairly and quickly.[10] In situations involving Ponzi-like schemes, the trustee often uses Code provisions, known tellingly as the clawback provisions, or turns to state law Uniform Fraudulent Transfer Acts ("UFTA") for more advantageous clawback periods.[11] The perpetrator is the logical choice to recapture any mismanaged investments; however, the trustee steps back even further, looking for those investors who walked away happily.[12] That happiness is short lived once the trustee's investigation initiates, as the trustee intends to find those investors who received payments of funds in excess of their principal investments.[13] In an attempt to right an evident wrong, those payments are clawed back into the estate or the Fund for redistribution to those investors with lesser fortune.[14]

The trustee may use preferential clawbacks under § 547 of the Code to recover funds transferred within ninety days of the bankruptcy or liquidation, or even further in the case of insiders.[15] There are limited and naturally unavailing defenses to the preferential clawback.[16] For transfers exceeding the ninety-day period, the trustee may turn instead to the fraudulent transfer provision under § 548 of the Code.[17] In these circumstances, the clawback may reach back two years under federal law.[18] But, dissimilar to the preferential transfer, there are sturdier, more reliable defenses that are often used successfully to some degree.[19] Yet, rarely, if ever, will the defense cover the entirety of the transfer.[20] Where we see most of the action is through the utilization of § 544(b) of the Code. Section 544(b) permits the

10. 11 U.S.C. § 704(a)(1).

11. *See* Levit v. Spatz (*In re* Spatz), 222 B.R. 157, 160 (N.D. Ill. 1998).

12. Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 531 B.R. 439, 449 (Bankr. S.D.N.Y. 2015).

13. Donell v. Kowell, 533 F.3d 762, 779 (9th Cir. 2008).

14. *Id.*

15. Jobin v. McKay (*In re* M & L Bus. Mach. Co.), 155 B.R. 531, 534–39 (Bankr. D. Colo. 1993), *aff'd*, 164 B.R. 657 (D. Colo. 1994), *aff'd*, 84 F.3d 1330 (10th Cir. 1996).

16. *Id.* at 535–39.

17. *See, e.g.*, Floyd v. Dunson (*In re* Ramirez Rodriguez), 209 B.R. 424, 432 (Bankr. S.D. Tex. 1997).

18. 11 U.S.C. § 548(a)(1).

19. Kapila v. Integra Bank, N.A. (*In re* Pearlman), 440 B.R. 569, 576–77 (Bankr. M.D. Fla. 2010), *aff'd*, 478 B.R. 448 (M.D. Fla. 2012).

20. Donell v. Kowell, 533 F.3d 762, 771 (9th Cir. 2008).

trustee to insert him or herself into the shoes of a hypothetical judicial lien creditor, essentially opening the gates for the entrance of state law UFTA provisions.[21]

Expediency and equitability are the core foundations of the trustee's purpose to recover and return lost funds.[22] As the saying goes, "[a] dollar today is worth more than a dollar tomorrow. . . ."[23] The longer the recovery process takes, the less likely it becomes that injured creditors will return to their financial position prior to the transaction. For the most part, state courts acquiesce to this goal by deducing that certain presumptions arise.[24] Ponzi scheme presumptions arise in a three-part context: (a) transfers are made with *actual intent*; (b) an entity running the Ponzi scheme is *insolvent* from inception; and (c) any amount over the principal investment does not constitute *reasonably equivalent value*.[25] By way of the presumptions , courts allow the trustees to eschew from drawn out defensive proceedings that inhibit the rapid return of funds. Nevertheless, recent rulings in state courts have concluded that, in fact, there are no presumptions.[26] This is a cause for concern for the trustees who are handling hundreds, if not thousands, of clawback claims. The position of this Article is that state courts must maintain the Ponzi presumption and other associated presumptions, in order to facilitate the expeditiousness of proceedings and to achieve equitable outcomes.

This Article will proceed by first covering Ponzi schemes in-depth, focusing on related red flags and the background of the Petters, Stanford, and Madoff fraudulent schemes. Investors need to identify the relevant red flags associated with Ponzi schemes, as the presence of red flags generally defeats defenses creditors may posit. Next, a discussion of SIPA and the SIPC will take place to provide an understanding of clawback goals and the processes

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21. *Id.* at 775 n.7. *See also* Rieser v. Hayslip (*In re* Canyon Sys. Corp.), 343 B.R. 615, 634–35 (Bankr. S.D. Ohio 2006).

22. 11 U.S.C. § 704(a)(1).

23. Lifetime Brands, Inc. v. ARC Int'l., SA, No. 09 Civ. 9792, 2010 WL 454680, at *2 (S.D.N.Y. Jan. 29, 2010).

24. *See, e.g.*, Bear, Stearns Sec. Corp. v. Gredd (*In re* Manhattan Inv. Fund Ltd.), 397 B.R. 1, 11 (S.D.N.Y. 2007) (noting that multiple courts have applied the "Ponzi scheme presumption").

25. Kelley v. Opportunity Fin., LLC (*In re* Petters Co.), 550 B.R. 457, 462 (Bankr. D. Minn. 2016).

26. Finn v. All. Bank, 860 N.W.2d 638, 654 (Minn. 2015); Janvey v. Golf Channel, Inc., 487 S.W.3d 560, 581 (Tex. 2016).

established to attain those goals. This discussion should enlighten the reader of the purpose of the clawback process and the trustee's role as it pertains to fairness and rapid results.[27] Afterward, the discussion will move to proper clawback claims, covering who is a customer with an allowed claim, and supplying the reader with an understanding as to the equitable foundation of clawbacks. The theories of recovery will then be introduced—namely, preferential transfers, fraudulent transfers, state law fraudulent transfers, and the relevant defenses. In that Part, the Article will explore the discourse concerning equitability and the propriety of clawback actions to expand the reader's understanding of arguments against clawbacks. The Florida Uniform Fraudulent Transfer Act ("FUFTA") will be analyzed to provide a general example to readers. This Article will also briefly consider the stockbroker safe-harbor provision under § 546(e) of the Code and discuss the new direction of Ponzi schemes and the potential effect on clawbacks. That information is purely for the reader's interest and does not affect the Article's thesis. Next, we will get into the heart of the research on the Ponzi scheme presumptions, where recent Minnesota and Texas cases will be examined. Here, this Article will introduce the concept of encoding a Ponzi provision in UFTA to ameliorate concerns by the courts and the trustees.

Ultimately, this Article recommends that state courts preserve the presumptions to uphold justice and fairness of the clawback process. To do so, state legislatures should incorporate a provision into UFTA detailing the exact nature of a Ponzi scheme and when the presumptions arise. This Article, at bottom, discourages the notion that presumptions should be disposed of in favor of proving express statutory elements, as such a requirement is plainly contrary to the Congressional objective to protect investors through the actions of the SIPA trustee.

## *II. WHAT ARE PONZI SCHEMES?*

The term "Ponzi scheme" was coined roughly one hundred years ago, after the Boston fraudster Carlo Pietro Giovanni Guglielmo Tebaldo Ponzi, commonly known as Charles Ponzi.

27. While the liquidation aspect of Ponzi scheme clawbacks is a critical part of the process, this Article focuses predominantly on the bankruptcy arena.

Notably, Charles' idea was not original. Tracing the idea through history, the origins are located through the mind's eye of Charles Dickens in the 1844 fictional novel *The Life and Adventures of Martin Chuzzlewit*.[28] Whether related or not, the concept spread like wildfire in the wake of Dickens' fictional account.

In the late 1800s, two female fraudsters, Adele Spitzeder and Sarah Howe, appear to have operated the first recorded Ponzi schemes.[29] Offering incredible returns on investments, Spitzeder, considered at one point to be the wealthiest woman in Bavaria, alone defrauded 32,000 people out of 38 million gulden, a total equivalent to $430 million in 2022.[30] Mr. "520 percent," a name given to William Miller in 1899 due to his astonishing claimed rate of return, defrauded New Englanders of nearly $25 million in 2021 dollars.[31] The popularity of Ponzi schemes among fraudsters and the devastating financial effect of those fraudulent schemes has surged over the years.

During the period spanning from 2008 to 2020, nearly one thousand Ponzi schemes were uncovered, totaling over $62.5 billion.[32] Given the abysmal levels of financial literacy amongst millennials (only 24% demonstrate basic financial literacy[33]), in conjunction with the emergence of innovative and complex new investment mediums such as cryptocurrency—by itself, harmless,

28. *See generally* CHARLES DICKENS, THE LIFE AND ADVENTURES OF MARTIN CHUZZLEWIT (Glob. Grey 2020) (1844) (ebook). In the novel, a petty thief nicknamed Tigg Montague pretends to be a gentleman who finances the purchase of high-quality clothing. In all reality, Montague had stolen Chuzzlewit's watch to finance the first purchase. Nevertheless, investors were enticed by his false success and bought into the financing scheme, which ultimately led to the ruin of many and the murder of Montague.

29. *The "Woman's Banker" Dead*, BOS. WKLY. GLOBE, Jan. 26, 1892, at 3; Matthew Partridge, *Great Frauds in History: Adelheid Luise Spitzeder*, MONEYWEEK (July 31, 2019), https://moneyweek.com/511836/great-frauds-in-history-adelheid-luise-spitzeder.

30. Partridge, *supra* note 29; Robert F. Mulligan, *Adele Spitzeder, the Queen of Confidence Tricksters*, AM. INST. FOR ECON. RSCH. (May 2, 2022), https://www.aier.org/article/adele-spitzeder-the-queen-of-confidence-tricksters/.

31. Adam Cohler, The Evolution and Impacts of the Ponzi Scheme and Governmental Oversight (Apr. 12, 2017) (B.B.A. thesis, Ramapo College) (on file with Ramapo College); Erin Skarda, *Top 10 Swindlers*, TIME (Mar. 7, 2012), https://content.time.com/time/specials/packages/article/0,28804,2104982_2104983_2104992,00.html.

32. *The Ponzi Scheme Database*, PONZITRACKER: THE PONZI SCHEME AUTHORITY, https://www.ponzitracker.com/ponzi-database (last visited Sept. 15, 2024).

33. Kevin P. Chavous, *A Hand Up or a Handout? Tackling America's Financial Literacy Crisis*, FORBES, https://www.forbes.com/sites/stopaward/2022/02/03/a-hand-up-or-a-handout-can-we-tackle-americas-financial-literacy-crisis/ (Feb. 9, 2022, 4:18 AM).

but, as the "Wild West" of the investment world,[34] presenting opportunities for spectacular fraud, as seen with crypto exchange FTX—it becomes evident that the pervasiveness of Ponzi schemes will not decline. Technology allows fraudsters to skirt government oversight and directly target victims. Knowledge of the past and the presence of mind to be vigilant in the future may mitigate some of these issues. Still, the enticing offers by fraudsters will continue to blind the investors' insatiable desire to seek promising returns.

So, what exactly is a Ponzi scheme? The Securities and Exchange Commission ("SEC") advances a simplistic yet clairvoyant definition: "A Ponzi scheme is an investment fraud that pays existing investors with funds collected from new investors."[35] Conversely, the Eleventh Circuit utilizes a detailed definition: "A Ponzi scheme uses the principal investments of newer investors, who are promised large returns, to pay older investors what appear to be high returns, but which are in reality a return of their own principal or that of other investors."[36] This definition highlights the core business model for most schemes—bringing in new investors. Most perpetrating entities "conduct little to no legitimate business operations."[37] Rather, the goal is to maintain the flow of new investors, the stoppage of which is devastating for the scheme.

The constant need for new investors presents both the means to survive and the coup de grâce for fraudulent schemes. Inevitably, growth results in exposure and an eventually impossible amount of return claims to meet. As such, the very nature of a Ponzi scheme leads to its ultimate demise. While the previous statements are accurate, you will see below how ingenuity and the art of deception keep the most mischievous scheme operators afloat for many years.

The next part will cover identification of red flags, which is particularly important because the presence of red flags may put

34. Jon Frost, *Is Crypto Really the Wild West? Yes – and in more ways than the obvious*, THE FINREG BLOG (Sept. 3, 2024), https://sites.duke.edu/thefinregblog/2024/09/03/is-crypto-really-the-wild-west-yes-and-in-more-ways-than-the-obvious/.

35. U.S. Sec. & Exch. Comm'n, *Ponzi Schemes*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/ponzi-schemes (last visited Sep 15, 2024).

36. Wiand v. Lee, 753 F.3d 1194, 1201 (11th Cir. 2014).

37. *Id.*

an investor on notice of a fraudulent scheme.[38] Notice plays a vital role in the clawback process because notice may defeat an investor's partial defense to clawbacks.[39] Further, the philosophy behind barring the defense underscores the significance of equitability between creditors, thereby advancing the thesis of this Article.[40]

## *III. THE SEC'S PONZI SCHEME RED FLAGS*

Despite the inventiveness of each scheme in its own respect, red flags are invariably present. Rarely will only one red flag appear. Oftentimes, Ponzi schemes are characterized by a confluence of red flags, yet even proficient investors are duped—or, in some cases, willfully turn a blind eye.[41] We can chalk this up to the art of deception, where masters of the craft minimize the effect of red flags and essentially force the investors to turn a blind eye.[42] However, as you will see, this is no defense for the investor when facing the clawback.[43] Please note, this discussion of red flags is not central to the thesis, but is an important aspect of clawbacks of which the reader should be aware. The following are red flags established by the SEC to put investors on notice.[44]

38. *See, e.g.*, Wiand v. Buhl, No. 8:10–cv–75–T–17, 2013 WL 12198453, at *12 (M.D. Fla. Jan. 11, 2013).

39. *Id.*

40. *Id.* at *11. Where an investor is aware of the fraudulent nature of the scheme, courts are hesitant to allow any return of investment at all. *Id.* This highlights the fairness aspect of recovery because one creditor should not knowingly profit at the expense of the other creditors—all creditors should be on the same playing field. *Id.*

41. *Id.* at *13.

42. During preparation for this paper, I had a discussion with Bob Persante regarding Lou Pearlman's Ponzi scheme. Mr. Persante emphasized the fraudsters' masterful ability to shift the focus away from red flags using crafty techniques. An example of one such technique is when Pearlman assured investments were covered through an EISA program, which could easily be misconstrued by the investor as being the legitimate ERISA federal program. Telephone Interview with Bob Persante. (Oct. 29, 2021).

43. Picard v. Avellino (*In re* Bernard L. Madoff Inv. Sec. LLC), 557 B.R. 89, 113 (Bankr. S.D.N.Y. 2016) (quoting Picard v. Katz, 462 B.R. 447, 455 (S.D.N.Y. 2011).

44. U.S. Sec. & Exch. Comm'n, *Investor Alert: Ponzi Schemes Using Virtual Currencies*, INVESTOR.GOV (July 23, 2013), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/investor-7.

### A. "High Investment Returns with Little or No Risk"[45]

This is the definitive red flag—what truly draws the victim investors into the scheme. But this certainly should raise eyebrows as all investments carry a degree of risk, especially investments permitting high returns.[46] In the age of cryptocurrency like Bitcoin, distinguishable because of its high returns, virtual currency Ponzi scheme operators are given an opportunity to exploit investors in a market with very little government oversight without attracting attention to this red flag.[47] The SEC has recently warned of the popularity of Bitcoin Ponzi schemes.[48]

### B. "Overly Consistent Returns"[49]

If the investor is receiving the same return period after period, this should alert the investor that there may be fraudulent activity.[50] The investor should be concerned irrespective of market conditions.[51]

### C. "Unregistered Investments"[52]

Securities investments should be registered with the SEC or state securities regulators.[53] This underscores the notion that investors, with respect to any investment, should invest with skepticism, researching the investment before making it.

### D. "Secretive and/or Complex Strategies and Fee Structures"[54]

This red flag is evident in many schemes.[55] Investors should always be wary of any investment that is lacking in information.[56]

45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*
55. *See infra*, Part IV (Madoff, Stanford, and Pearlman Ponzi scheme discussions).
56. U.S. Sec. & Exch. Comm'n, *supra* note 44.

Fraudsters may use confidentiality as a shield against sharing information, but investors need to stay diligent.[57]

### E. "Issues with Paperwork"[58]

Issues with paperwork arise alongside the red flag directly above. If the investor cannot obtain accurate and adequate information on the investment, they should avoid it at all costs.[59] The fraudster may provide basic information or fraudulent information, all of which should be thoroughly examined by the investor.[60]

### F. "Difficulty Receiving Payments"[61]

Ponzi scheme organizers offer incentives to hold investments for longer periods.[62] Why? Because they do not want to pay. Each payment entails the need for a new investment. If the investor cannot cash out, or if they are encouraged to hold their investment, the investor should be suspicious of potentially fraudulent activity.[63]

### G. "Shared Affinity"[64]

Shared affinity is a major selling point for fraudsters. These individuals and entities exploit those who trust them most.[65] Major schemes have been perpetrated by religious leaders, lawyers, celebrities, and those present in the political arena.[66] The ability to leverage status and trust is one of the preeminent persuasive

57. Pearlman dissuaded investors from inquiring into the insurance policy of Trans Continental Airlines by citing to confidentiality concerns. Persante, *supra* note 42.
58. U.S. Sec. & Exch. Comm'n, *supra* note 44.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*
65. *See id.*
66. Breeanna Hare & Marika Gerken, *8 of the Most Notorious Ponzi Schemes in History*, CNN (Apr. 24, 2021, 8:10 AM), https://www.cnn.com/2021/04/24/business/famous-ponzi-schemes-generation-hustle

tactics enabling the manipulation of investors. In the words of fraudster Lou Pearlman, "If you do not believe, then just leave."[67]

Lou Pearlman's Ponzi scheme serves as an excellent example of red flags and masterful deception in action. As preparation for this paper, I had a conversation with Bob Persante, an attorney who was retained by defrauded investors to pursue Lou Pearlman.[68] The name may ring a bell if you are a fan of the popular mid-90's boybands NSYNC and the Backstreet Boys.[69] Pearlman was initially a record producer who formed those bands, among others.[70] Using his status as a celebrity,[71] Pearlman would bring investors to his mansion for a sit down.[72] Sitting at his desk, surrounded by award plaques and pictures with centers of influence, Pearlman leveraged his status to persuade people to invest in his fictitious airline, Trans Continental Airlines ("TCA").[73] He assured investors that there was no risk to the investment[74] due to TCA's insurance policy—which, of course, Pearlman could not unveil for confidentiality reasons.[75] [76] Those investors were given a pamphlet explaining the "opportunity" to garner high rates on jumbo certificates of deposit.[77] If the investor let the investment compound, he could get 8.8% return, but if he took it out quarterly, only 3.8% was available.[78] [79] Pearlman provided audited financials showing TCA had millions of dollars.[80]

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67. If Pearlman was confronted with suspicions, he would make this statement. In effect, removing all of those who would not buy into his salesmanship. Persante, *supra* note 42.

68. *Id.*

69. Allie Yang, Ed Lopez, & Gwen Gowen, *How Lou Pearlman Used Backstreet Boys, *NSYNC to Lure People into Massive Ponzi Scheme*, ABC NEWS (Dec. 13, 2019, 12:44 PM), https://abcnews.go.com/US/lou-pearlman-backstreet-boys-nsync-lure-people-massive/story?id=67630954.

70. *Id.*

71. An example of the use of "shared affinity," a red flag identified above.

72. Persante, *supra* note 42.

73. *Id.*

74. An example of the aforementioned red flag related to investments with a purported lack of risk.

75. *Id.*

76. An example pertaining to the red flags: "Issues with Paperwork" and "Secretive and/or Complex Strategies."

77. *Id.*

78. *Id.*

79. An example of high investment returns and overly consistent returns, both of which are red flags. This example further relates to difficulties in receiving payments, as the investors are incentivized to hold the investment.

80. *Id.*

Once the scheme was uncovered, the CPA firm that provided those financial statements was contacted.[81] Unsurprisingly, that firm was similarly fictitious.[82] Pearlman's case involves the interaction of multiple red flags, discussed above, and his ability to subvert concerns ended with detriment to the investors. The reader should take notice of the deceptive nature of the scheme as an example of obscuring red flags. Burt Wiand, the receiver for the Pearlman clawbacks, eventually recovered millions of dollars for duped investors.[83]

The next part details three of the largest Ponzi schemes discovered. This part is significant because it gives the reader background of the Petters and Stanford Ponzi schemes—two cases used as vehicles for state courts to defeat the Ponzi scheme presumptions. The Madoff case will also be further discussed to a degree to give the reader insight into the clawback processes.

## *IV. HISTORIC PONZI SCHEME CASES*

The following examples involve three of the most historically egregious Ponzi schemes. The magnitude of fraud and the widespread financial impact of these schemes stresses the need for an equitable instrument, as encompassed in SIPA clawback actions. All three of these cases will resurface as this paper continues to unfold. The reader should note the vastness of the schemes and that the Petters and Stanford schemes, in particular, incorporate legitimate and illegitimate portions of business. Ponzi schemes integrating both types of business led to the current conundrum in state courts, which plays a vital role in the formulation of this Article's thesis.

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81. *Id.*
82. *Id.*
83. Also, in preparation of this paper, I had the opportunity to interview Burton Wiand, the receiver in the Lou Pearlman case and many others. That discussion played a major role in the formulation of my thesis that the Ponzi presumptions must stand. Telephone Interview with Burton Wiand, Wiand's Institutional Affiliation. (Nov. 12, 2021).

### A. Petters Company, Inc./Petters Group Worldwide

Major Ponzi schemes frequently unravel from the inside, emphasizing the difficulty of discovery for authorities.[84] In 2008, Deanna Coleman, one of Tom Petters' employees, exposed the $3.7 billion scheme that had continued for over a decade.[85] From its very inception, Petters Company, Inc. ("PCI") was a fraudulent scheme focused on generating fictitious documents, buying false warehouse spaces, and ultimately inducing investors to loan billions of dollars.[86] The investments were purportedly used to purchase merchandise that would be resold to mainstream retailers for profit.[87] Upon raiding Petters' residence and businesses, federal law enforcement agents found counterfeit purchase orders showing PCI was owed over $3 billion by large retailers such as Costco and Sam's Club.[88] Petters is currently in prison, serving a 50-year sentence.[89]

After nearly 13 years, the Petters Ponzi scheme receivership closed in mid-2021 after recovering over $722 million for victims.[90] In the process of liquidation and clawing back funds, the court faced a daunting 3,300 docket [case] entries.[91] Again, to hammer down the point, it is evident the vastness of these Ponzi scheme cases emphasizes the need for expediency in the courts. The quicker funds can be returned to victims, the quicker true restitution can be accomplished.

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84. *See* Danielle Kfir (Dulitzky), *The Challenges of Identifying and Preventing Ponzi Schemes*, N.Y.U. J. L. & BUS. (Mar. 5, 2018), https://www.nyujlb.org/single-post/2018/03/05/the-challenges-of-identifying-and-preventing-ponzi-schemes.

85. United States v. Petters, 663 F.3d 375, 379 (8th Cir. 2011).

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.* at 380.

90. Press Release, U.S. Att'y's Off. Dist. of Minn., Federal Judge Closes Receivership in Petters Ponzi Scheme Case; More Than $722 Million Distributed to Victim Investors (July 30, 2021), https://www.justice.gov/usao-mn/pr/federal-judge-closes-receivership-petters-ponzi-scheme-case-more-722-million-distributed.

91. *Id.*

### B. Stanford International Bank

Financial crises are another source that upends fraudulent schemes.[92] Investors flock in droves to redeem their investments only to find that the fraudster cannot pay. The 2008 economic recession brought the downfall of the two largest Ponzi schemes in history.[93] In Stanford's case, a receiver was appointed and government investigations began, uncovering decades of fraud through financial investigation and testimony of Stanford's inner circle.[94]

Stanford International Bank, Ltd. ("SIB"), an Antiguan-based bank established around 1990, offered certificates of deposit at higher rates of return than their American counterparts.[95] Eventually, Stanford, whose work in Antigua resulted in a knighthood which was subsequently revoked,[96] founded the Stanford Group Company in Texas to continue the fraudulent practice in the United States.[97] As the $7 billion scheme unraveled, it became patently clear that it could be traced back to the very beginning of the business.[98] Stanford and his CFO deceived investors and funneled money for personal use—including lavish spending, such as the purchase of boats, mansions, and personal aircraft, as well as sponsorship of high-dollar cricket tournaments—and continued the scheme by using recent sales of certificates of deposit to pay investors with maturing certificates.[99] Stanford was sentenced to 110 years in Florida prison.[100] After more than 12 years, the receivership for the Stanford Ponzi scheme has recovered over $1 billion.[101]

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92. *See* Paul Sullivan, *A Bigger Risk than GameStop? Beware the Ponzi Scheme Next Door*, N.Y. TIMES, https://www.nytimes.com/2021/02/05/your-money/ponzi-schemes-stock-market.html (Apr. 14, 2021).

93. *Id.*

94. United States v. Stanford, 805 F.3d 557, 564 (5th Cir. 2015).

95. *Id.* at 563.

96. James Chen, *Allen Stanford: Who he is, Backstory, Financial Impact*, INVESTOPEDIA (June 10, 2022), https://www.investopedia.com/terms/s/sir-allan-stanford.asp.

97. Stanford, 805 F.3d at 564.

98. *Id.*

99. *Id.*

100. *Id.* at 565.

101. Jonathan Stempel, *Allen Stanford's Ponzi Scheme Recovery Tops $1 Billion*, REUTERS (Sep. 20, 2021, 11:57 AM), https://www.reuters.com/business/finance/allen-stanfords-ponzi-scheme-recovery-tops-1-billion-2021-09-20/.

### C. Bernie L. Madoff Investment Securities

Perhaps the most infamous fraudster of all time, Bernie Madoff's Ponzi scheme similarly faced its downfall following the 2008 financial crisis. The crisis caused the scheme to unravel when investors requested a return of $7 billion, at which point Madoff confessed his heinous actions to his children.[102] Subsequently, his children turned him in to federal authorities.[103]

Madoff was well-known in the financial industry; at one point, he sat as a chairman for NASDAQ.[104] People trusted him. In fact, people trusted him to the tune of around $65 billion.[105] Investors ranged from celebrity icons, such as Steven Spielberg, to charities, and every day, run-of-the-mill investors.[106] Madoff's financial plan on paper was sound, as he used a strategy deemed the "split-strike conversion."[107] But something was clearly amiss when the market downturn did not affect positive returns. Madoff was crafty in his scheme because he would not create spectacular returns that would raise eyebrows.[108] Despite Madoff's age, the Court made a statement to the wickedness of the scheme by sentencing Madoff to 150 years in prison.[109]

Irving Picard is the appointed SIPA trustee for Bernie L. Madoff Investment Securities. Picard has brought thousands of clawback claims, some of the claims for hundreds of millions of dollars. As of September 2021, the total payout to nearly 31,000

102. Stephanie Yang & Grace Kay, *Bernie Madoff Died in Prison After Carrying Out the Largest Ponzi Scheme in History – Here's How it Worked*, BUS. INSIDER AFR. (Apr. 14, 2021, 7:11 PM), https://africa.businessinsider.com/finance/bernie-madoff-died-in-prison-after-carrying-out-the-largest-ponzi-scheme-in-history/8m8djvm.

103. Kaitlin Menza, *How Bernie Madoff Took His Family Down*, TOWN & COUNTRY (Apr. 14, 2021), https://www.townandcountrymag.com/society/money-and-power/a9656715/bernie-madoff-ponzi-scheme-scandal-story-and-aftermath/.

104. Yang & Kay, *supra* note 102.

105. *Id.*

106. Menza, *supra* note 103.

107. Picard v. Avellino (*In re* Bernard L. Madoff Inv. Sec. LLC), 557 B.R. 89, 97 (Bankr. S.D.N.Y. 2016).

108. *See id.*

109. Yang & Kay, *supra* note 102.

victims was over $18 billion and counting.[110] Recovery for victims amounts to 81.35% of their losses, per the Justice Department.[111]

## *V. THE FUTURE OF PONZI SCHEMES—VIRTUAL CURRENCY*

Virtual currency, or cryptocurrency, investments are slowly becoming a universal means to amass fortune.[112] The general lack of knowledge regarding complex and technological strategies, coupled with the privacy benefits and lack of regulatory oversight, offer an attractive option to fraudsters.[113] Ponzi scheme operators may use online forums or other forms of social media to rope in unknowing victims.[114] High rates of return are not uncommon in the world of cryptocurrency, so both experienced and inexperienced investors may be duped. The pervasiveness and increasing popularity of cryptocurrency may lead to a proliferation of virtual currency Ponzi schemes.[115] Attorneys and investors should be aware of and avoid these schemes.[116] [117]

Now that the reader has been briefed on the basics of Ponzi schemes and the red flags investors should be aware of, the Article will shift to a discussion of SIPA. Understanding how clawbacks

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110. Jonathan Stempel, *More Money on Way for Bernard Madoff Victims, Total Payouts Top $18 Billion*, REUTERS (Sept. 16, 2021, 1:33 PM), https://www.reuters.com/legal/government/more-money-way-bernard-madoff-victims-total-payouts-top-18-billion-2021-09-16/.

111. *Id.*

112. Carmen Reinicke, *Cryptocurrencies Can Be a Tool for Building Personal Wealth Long-Term*, CNBC, https://www.cnbc.com/2021/07/27/cryptocurrencies-can-be-a-tool-for-building-personal-wealth-long-term.html. (Jul. 29, 2024, 1:45 PM).

113. U.S. Sec. & Exch. Comm'n, *supra* note 44.

114. *See e.g.*, SEC. v. Shavers, No. 4:13-CV-416, 2013 WL 4028182, at *1 (E.D. Tex. Aug. 6, 2013).

115. U.S. Sec. & Exch. Comm'n, *supra* note 44.

116. *SEC v. Shavers*, 2013 WL 4028182, exhibits one such scheme. According to the case background, Shavers created "Bitcoin Savings and Trust" to solicit lenders to invest in Bitcoin-related investment opportunities. *Id.* at *1. The scheme duped investors by advertising the strategy as an opportunity to purchase percentages of a Bitcoin with other investors, offering a one percent daily return. *Id.* Shavers accumulated 700,467 Bitcoin, while investors collectively lost 263,104 Bitcoin. *Id.* As of November 2021, assuming a rate of around $58,000 per Bitcoin, 700,000 Bitcoin is worth an astonishing $40 billion. STATMUSE, https://www.statmuse.com/money/ask/bitcoin-price-in-november-2021-usd (last visited Sept. 16, 2024).

117. Virtual-currency-Ponzi-scheme cases are frequently popping up around the globe. This Article will not delve into the discussion, but a system must be put in place to counter fraudsters' activities with regard to cryptocurrency and other virtual assets. As for now, this market remains heavily unregulated.

are initiated requires comprehension of the components of SIPA and the role of the trustee. This is crucial to the thesis because SIPA's essential purpose is to instill confidence in investors, and one of the ways trustees accomplish that goal is by attempting to put investors back in the position they were prior to the Ponzi scheme. Notably, the trustee is mandated to do so in the quickest manner possible.[118] This stresses the necessity of Ponzi scheme presumptions that quicken the litigation proceedings.

## *VI. THE SECURITIES INVESTOR PROTECTION ACT ("SIPA") (1970)*

While it is possible for failing Ponzi schemes to proceed voluntarily under the Bankruptcy Code, it is far more likely the scheme will fall under SIPA involuntary liquidation and subsequent removal of the liquidation to bankruptcy proceedings. SIPA was enacted following a surge in the popularity of the securities industry in the 1960s.[119] Brokerage firms were facing financial problems and undergoing liquidation and bankruptcies—proceedings that tied up investors' funds and diminished investor confidence in capital markets.[120] Congress reacted by enacting SIPA to reassert confidence in investors and streamline the bankruptcy-liquidation processes, among other purposes.[121] SIPA is the governing body of law for many Ponzi scheme insolvency proceedings. Notably, SIPA establishes the SIPC—a nonprofit corporation not characterized as an agency or governmental body—composed of all registered brokers or dealers.[122] As a general matter, the SIPC serves as a backstop for investors, offering up to $500,000 as protection in the event of loss of cash or securities held by the investor at an SIPC-member brokerage firm.[123] Next, the role of the SEC will be explored, given its status as a major player in SIPA.

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118. 11 U.S.C. § 704(a)(1).
119. *Securities Investor Protection Act (SIPA)*, U.S. COURTS (Aug. 29, 2024, 9:38 PM), https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/securities-investor-protection-act-sipa.
120. *Id.*
121. *Id.*
122. 15 U.S.C. § 78ccc(a)(1), (2).
123. *Investor Protection: What SIPC Protects*, SIPC, https://www.sipc.org/for-investors/what-sipc-protects (last visited Oct. 5, 2024).

## A. SEC's Role

The SEC embodies the role of an oversight agency by regulating and supervising the activities of the SIPC, while simultaneously promulgating the rules and reporting obligations SIPC member firms must follow.[124] Member firms undergo SEC inspections and reviews to ensure financial responsibility.[125] When the SIPC acquires information regarding a member firm's failure or potential failure, it files a civil case where the SEC may be named as a plaintiff.[126] If the SIPC refuses to act, the SEC may file in the U.S. District Court for the District of Columbia to require SIPC action.[127]

## B. Important SIPA Provisions

The SIPC Fund is also created through SIPA, the purpose being to deposit excess funds for use for any SIPC expenditures.[128] Section 5 of SIPA denotes the purpose of the Act: "Protection of *customers*" (a term of art to be defined *infra*).[129] Next, SIPA presents the standard for appointment of the trustee, an individual appointed by the court at the direction of the SIPC.[130] Importantly, section 5(b)(4) expresses the need to remove liquidation proceedings to bankruptcy courts to continue as an adversary proceeding.[131] Section 7 places the powers and duties of the SIPA trustee, which will be detailed in the next subsection of this paper.[132] Fraudulent transfers from which clawbacks arise are implicated in subsections 14(c)(1) and (2), Prohibited Acts.[133] The final section of SIPA covers all of the definitions, which are crucial to understanding the clawback process and the overall purpose of the Act.[134]

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124. *Securities Investor Protection Act (SIPA)*, *supra* note 119.
125. 15 U.S.C. § 78ggg(c).
126. *Securities Investor Protection Act (SIPA)*, *supra* note 119.
127. 15 U.S.C. § 78ggg(b).
128. *Id.* § 78ddd(a)(1).
129. *Id.* § 78eee.
130. *Id.* § 78eee(b)(3).
131. *Id.* § 78eee(b)(4).
132. *Id.* § 78fff-1.
133. *Id.* § 78jjj(c)(1), (2).
134. *Id.* § 78lll.

## C. The SIPC: Liquidation, Bankruptcy, and the Role of the Trustee

To understand how SIPA operates, the next three sections detail how the proceedings function. Within those sections, the reader will notice the recurring goal of fairness and the expeditiousness required to meet that goal. As mentioned in the prior part, the SIPC is a nongovernment, nonprofit organization.[135] The SIPC plays the enforcer, regulator, and protector under SIPA. Comparisons can be drawn between the Federal Deposit Insurance Corporation ("FIDC") and the SIPC—both give confidence to the customers in their respective industries by offering equitable protections. SIPC action is not limited solely to Ponzi schemes, instead, the focus is broadly placed on failed brokerage firms.[136] Generally, the SIPC will take brokerage firms through liquidation by removal to the bankruptcy courts.[137]

### *1. Liquidation*

Liquidation begins with the end of the brokerage firm, as the trustee closes the offices and organizes records for the upcoming proceedings. Assets are sold or, in some cases, maintained by the trustee if the asset can generate further funds for the estate.[138] Lawsuits are initiated to claw back funds and recover any other assets possible to the extent the debtor's assets and the SIPC Fund are insufficient.[139] Essentially, the trustee creates a piggy bank to return funds to customers.

In turn, the trustee will then seek to restore securities and cash to customers in the quickest manner possible.[140] Herein lies one of the core themes differentiating the SIPC trustee from the typical Code trustee: Where the trustee under the Code seeks to distribute cash to customers in satisfaction of their claims, the SIPC trustee seeks to distribute both cash *and* securities *to the*

135. *Id.* § 78ccc(a)(1).
136. *Id.* § 78ccc(a)(2)(A).
137. *Id.* § 78eee(b)(4).
138. *Securities Investor Protection Act (SIPA)*, *supra* note 119.
139. *Id.*
140. 11 U.S.C. § 704(a)(1).

*furthest extent possible* in satisfaction of their claims.[141] Access to resources further distinguishes the SIPC trustee.[142]

### *2. Bankruptcy Court*

Under the guidance of SIPA, the case is removed to bankruptcy courts to stand as an adversary proceeding for liquidation.[143] The SIPA proceeding follows the procedures established in Chapters 1, 3, and 5, as well as subchapters I and II of Chapter 7 of the Code, subtly known as the clawback provisions.[144] These provisions enable the trustee to avoid transfers of interests in property made in furtherance of the Ponzi schemes by utilizing the avoidance-of-transfer procedures set forth in sections 544(b), 547(b), and 548(a). Each avoidance provision is used in connection with § 550(a), which allows, to the extent that a transfer is avoided under said sections, the recovery of the security itself or its value.[145]

### *3. Powers and the Role of the Trustee*

The purpose of the SIPC trustee in a Ponzi scheme action, summarizing the words of Irving Picard, is to oversee the liquidation, to recover assets stolen in the fraud, and to assemble a sufficiently large fund and estate in order to serve customers and creditors just compensation for their losses as a result of a Ponzi scheme.[146] Pursuant to SIPA, each trustee must be "disinterested," which implies a lack of direct or indirect relationship to the interest of the debtor or materially adverse to the interest of the customer.[147] The reader may recall, among other chapters, that SIPA follows Chapter 7 of the Code, which lays out in pertinent part that the trustee's principal duty is to "collect and reduce to money the property of the estate for which such trustee serves, and

141. *Securities Investor Protection Act (SIPA)*, *supra* note 119.
142. 15 U.S.C. § 78fff-1(a)(1)–(3).
143. *Id.* § 78eee(b)(4).
144. *Id.* § 78fff(b).
145. 11 U.S.C. § 550(a).
146. Irving H. Picard, *A Message from SIPA Trustee Irving H. Picard*, THE MADOFF RECOVERY INITIATIVE, https://www.madofftrustee.com/trustee-message-02.html (Nov. 19, 2021).
147. 15 U.S.C. § 78eee(b)(3), (6).

close such estate *as expeditiously as is compatible* with the best interests of parties in interest."[148] As such, haste is of the utmost importance.

The trustee has numerous duties, many of which are detailed above. The trustee facilitates customers' filing of claims, organizes claims and records, communicates with the court, and much, much more.[149] The SIPC trustee holds powers similar to that of the Chapter 7 trustee, but the trustee is further empowered to hire personnel and utilize SIPC employees necessary for any purpose of the liquidation proceeding.[150] Customer securities may be reduced to money by the trustee, effecting an efficient distribution process; however, the trustee must deliver securities to customers to the maximum extent possible.[151]

The trustee has some reporting duties to both the court and the SIPC.[152] Typically, these reports contain information on the acts, conduct, and condition of the debtor, as well as the progress of distributions to customers.[153] The trustee is the key player in actualizing a successful process by serving as the liaison to effect communication on all sides.

Ultimately, the SIPC trustee is given an extremely tough challenge. More often than not, these proceedings last many years and involve highly complex schemes. Aside from the legal complexities, the trustee has a heavy responsibility to swiftly recover as much as possible to help the victims of fraudulent schemes.[154] By incorporating the Ponzi presumptions discussed below, courts can streamline this process and remove time-consuming, and frankly unnecessary, obstacles to recovery.

## *VII. PROPER CLAWBACK CLAIMS*

Our discussion next turns to the basis upon which trustees act in the clawback processes. Each section herein illuminates the underlying purpose of equitability, detailing SIPA functions that attempt to level the playing field among creditors. Determination

148. 11 U.S.C. § 704(a)(1) (emphasis added).
149. 15 U.S.C. § 78fff-1.
150. *Id.* § 78fff-1(a)(1)–(2).
151. *Id.* § 78fff-1(b)(1).
152. *Id.* § 78fff-1(c).
153. *Id.*
154. 11 U.S.C. § 704(a)(1).

of a proper clawback claim is methodical and requires timely calculations, all of which result in administrative costs and expenses that will receive the highest priority when acquired funds are distributed.[155] All of these items play heavily into the Article's thesis, where, through use of the Ponzi presumptions, the ultimate goal is to restore the creditors to their initial positions in an expedient and pragmatic fashion.

Pursuant to SIPA, only "customers" with allowed claims are entitled to share ratably in "customer property" to the extent of their "net equities."[156] As simplistic as this may appear, these terms of art may be diluted during the interspersing of transfers among different entities.[157] This can create a complex trail, often requiring court analysis to determine who has a proper claim and who does not.[158] Disputes occur between the trustee and potential customers regarding certain claims and whether those claims meet the requirements for SIPA protection.[159] Next, the first step in determining a proper clawback claim will be covered—defining who is a "customer."

## A. Customer vs. Non-Customer

Because only customers are entitled to SIPA protection and the customer property fund, it is important to dive into the meaning of "customer." A vital element of the fund is that it is to be shared ratably by customers.[160] Basically, each customer receives a proportion of the fund equivalent to the extent of their net equity as determined by the Net Investment Method.[161] The property fund is highly sought after by investors, which explains the desire to fall under the definition of "customer."

Under SIPA, a customer is any individual or entity that deposits cash with a fraudster to purchase securities.[162] As stated

155. 15 U.S.C. § 78fff-2(c)(1)(A).
156. *Id.* § 78fff-2(c)(1)(B).
157. *See, e.g.*, Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (*In re* Bernard L. Madoff Inv. Sec. LLC), 424 B.R. 122, 125 (Bankr. S.D.N.Y. 2010).
158. *See id.*
159. *Id.*
160. *Id.* at 124-25.
161. *Id.* (noting that the Net Investment Method is the proper way to determine net equity).
162. 15 U.S.C. § 78lll(2).

decades ago by the Eleventh Circuit, "[a] 'customer' is anyone who entrusts securities, cash *or* other property with the debtor in connection with securities transactions, and loses said property due to the debtor's insolvency."[163] As such, a customer is not only one who deposits cash with the fraudster-debtor but, moreover, one who deposits any property with the debtor for securities purposes. Courts tend to focus on the "purposes of trading securities" aspect, said to be the "critical aspect of the 'customer' definition."[164]

The legislative history tells a similar story. The House Report on the 1970 Act makes it clear that the primary purpose of SIPA is to protect investors who entrust cash or property for some purpose connected with securities.[165] The Act was put in place to protect investors, and in following its mission, customers will typically constitute the duped investors with a direct relationship to the debtor in the fraudulent scheme.[166] Note, however, that in certain circumstances, such as when a defrauding entity is found to have no custody over the investors' cash or securities (i.e., the absence of entrustment of cash or securities for the *purposes of trading securities*), the investor does not qualify as a customer.[167]

### B. Allowed vs. Disallowed Claims: Calculating Net Equity

Only certain customers have allowable claims. The trustee must draw a distinction between those with allowed claims,

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163. Tew v. Res. Mgmt. (*In re* ESM Gov't Sec., Inc.), 812 F.2d 1374, 1376 (11th Cir. 1987).

164. *In re* Bernard L. Madoff Inv. Sec. LLC, 654 F.3d 229, 236 (2d Cir. 2011) (citing Appleton v. First Nat'l Bank of Ohio, 62 F.3d 791, 801 (6th Cir. 1995).

165. SEC. v. F.O. Baroff Co., 497 F.2d 280, 283 (2d Cir. 1974) (citing H.R. REP. NO. 91-1613, at 5255 (1970).

166. *Id.* at 284.

167. S.E.C. v. Securities Investor Protection Corp., 758 F.3d 357, 361, 363-64 (D.C. Cir. 2014) ("In SIPC's view, the CD investors were not SGC 'customers' within the meaning of the Act, a precondition to liquidation of SGC. SIPC explained that the Act 'protects the "custody" function that brokerage firms perform for customers.' J.A. 158. Here, SIPC concluded, the circumstances fell outside the Act's custody function because SGC itself never held investors' cash or securities in connection with their purchase of the CDs. Rather, 'cash for the purpose of purchasing CDs . . . was sent to SIBL, which is precisely what the customer intended.' J.A. 160. As for the 'physical CDs,' they presumably 'were issued to, and delivered to' the investors, and SGC did not 'maintain[ ] possession or control of the CDs.' J.A. 159–60. In short, 'SGC is not, nor should it be, holding anything for . . . a customer.' J.A. 160. 'The fact that the security has gone down in value, even because of a fraud in which SGC is complicit,' SIPC added, 'does not change that result.' J.A. 160. Because the CD investors failed to qualify as 'customers' of SGC within the meaning of the Act, SIPC concluded, the investors were ineligible for liquidation protection.").

typically deemed the losers, and those with disallowed claims, the winners. SIPA permits losing customers to recover "on the basis and to the extent of their respective net equities."[168] Thus, to determine allowed claims, the trustee must ascertain which of the customers still has net equity for the purposes of recovering from the fraudster-debtor. Pursuant to SIPA:

> The term 'net equity' means the dollar amount of the account or accounts of a customer, to be determined by— (A) calculating the sum which would have been owed by the debtor to such customer if the debtor had liquidated, by sale or purchase on the filing date— (i) all securities positions of such customer . . . ; minus (B) any indebtedness of such customer to the debtor on the filing date.[169]

Irving Picard established the Net Investment Method, which is detailed clearly in the case *In re Bernard L. Madoff Inv. Securities LLC*, 654 F.3d 229 (2d Cir. 2011). The Second Circuit, in line with the courts before it, noted that SIPA does not expressly specify any prescribed means of calculating net equity.[170] Instead, the duty falls to the courts to rationalize a fair method. Past cases used a myriad of methods, some falling under the now-defunct Last Statement Method.[171] However, it is evident now that courts will almost invariably use the Net Investment Method.[172]

The Net Investment Method credits the amount of cash deposited by a customer into their account, the principal

168. 15 U.S.C. § 78fff-2(c)(1)(B).

169. *Id.* § 78lll(11).

170. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 237.

171. *Id.* at 235. Without getting lost in the weeds, the issue with the Last Statement Method is associated with inequitable results. In this case, the winners would have obtained better treatment than their losing counterparts—resulting in the effectuation of Madoff's Ponzi scheme. The Second Circuit, in selecting the Net Investment Method over the Last Statement Method, emphasized that effectuation of the scheme will occur if creditors are permitted to keep funds sourced from other investors. Allowing creditors to keep other investors' funds, even in situations where the winning creditor is not directly involved in the Ponzi scheme, is against public policy and prior court holdings. Disposing of the presumptions in those circumstances is not in line with equitability. Keep this in mind as you read through the thesis.

172. *Id.* at 239 (noting that "the Net Investment Method is consistent with the purpose and design of SIPA.").

investment, minus any amounts withdrawn from it.[173] The Second Circuit cited to the bankruptcy court, which reasoned that this method is applicable and fair "because it relies solely on unmanipulated withdrawals and deposits and refuses to permit Madoff to arbitrarily decide who wins and who loses."[174] Simply put, those customers who withdrew less than their principal investment have allowed claims for the purposes of receiving clawback and SIPC Fund distributions.

### C. Customer Property Fund

Next, the Article will examine the "customer property fund," the purpose of which furthers the SIPA's principal objectives to protect investors against financial losses and to "'reverse los[s]es resulting from [fraud].'"[175] Customers of Ponzi schemes liquidated under SIPA are entitled to certain safeguards.[176] Notably, the customer property fund is separate from the debtor's general estate.[177] The fund is to be distributed in the manner covered below. Certain cash and securities received or held by the debtor-fraudster comprise the customer property fund—SIPA's definition of "customer property" notes that these funds include those at any time received or acquired.[178]

Whenever the customer property fund cannot meet the needs of the trustee, the trustee will initiate the clawback process to recover fraudulently transferred property.[179] Once received, the recovered property becomes and is treated as customer property.[180]

173. *Id.* at 233.

174. *Id.* at 238 (quoting Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (*In re* Bernard L. Madoff Inv. Sec. LLC), 424 B.R. 122, 140 (Bankr. S.D.N.Y. 2010)).

175. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 239 (quoting Miller v. DeQuine (*In re* Stratton Oakmont, Inc.), No. 01-CV-2812, 2003 WL 22698876, at *5 (S.D.N.Y. Nov. 14, 2003)).

176. *See* 15 U.S.C. § 78eee.

177. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d at 233.

178. *Id.*

179. *Id.*

180. *Id.* at 240 (mentioning specifically that "SIPA is intended to expedite the return of *customer property*"). The same is true in regard to the clawback process as a whole—the ideology behind the presumptions is to help facilitate this intention.

D. Distributions

Distributions will be paid out as prescribed by SIPA. Importantly, the first distribution is made to repay the SIPC for administrative costs and expenses.[181] As those costs increase, the equitability and expeditiousness of the process decrease, which highlights the impact of the evidentiary bypass found within the presumptions. According to SIPA:

> The trustee shall allocate customer property of the debtor as follows:
>
> (A) first, to SIPC in repayment of advances made by SIPC pursuant to section 78fff-3(c)(1) of this title, to the extent such advances recovered securities which were apportioned to customer property pursuant to section 78fff(d) of this title;
>
> (B) second, to customers of such debtor, who shall share ratably in such customer property on the basis and to the extent of their respective net equities;
>
> (C) third, to SIPC as subrogee for the claims of customers;
>
> (D) fourth, to SIPC in repayment of advances made by SIPC pursuant to section 78fff-3(c)(2) of this title.[182]

The advances referenced above acknowledge the SIPC's obligation to advance funds to the trustee to satisfy claims (up to $500,000 for securities and $250,000 for cash) and to pay for the costs and expenses of the debtor's business(es) administration and liquidation.[183] These advances are made only to the extent the debtor's estate cannot meet the costs, expenses, and claims.[184] Therefore, one of the trustee's goals of the clawback process should necessarily be to avoid costly actions.[185]

181. 15 U.S.C. § 78fff-2(c)(1)(A).
182. *Id.* § 78fff-2(c)(1).
183. *Id.* § 78fff-3(a)–(b), (d).
184. *Id.* § 78fff-3(b).
185. A good example of the costs associated with clawbacks arises in *S.E.C. v. Wealth Management LLC*, 628 F.3d 323, 330, 336 (7th Cir. 2010). The accumulated trust amounted to $6.3 million, but $2.1 million was retained by the receiver to cover administrative costs. *Id.* at 330. The Seventh Circuit, in affirming the district court's rejection of a case-by-case

## *VIII. THEORIES OF RECOVERY*

The ensuing sections will delve into the heart of the clawback process—the theories of recovery. The provisions discussed within are the core bases under which a trustee may pursue certain transfers. It will become evident to the reader that these provisions, absent the Ponzi presumptions, can involve highly technical calculations and determinations.[186] The time-consuming nature of the avoidance provisions is the key rationale for continuing the Ponzi presumptions.

In light of the above discussion on allowed claims, customers can be separated into two groups: the "winners" and the "losers." The winners are those who profited from the Ponzi scheme by withdrawing their principal investment and additional funds from their accounts with the fraudster.[187] Naturally then, the losers are those who still have residual principal amounts remaining in their accounts.[188] For a moment, consider the hypothetical case of Investor Sam. If Sam were to invest $1,000 in a Ponzi scheme and withdraw $900 throughout the life of the scheme, then he would be considered a "loser" with a $100 claim. Conversely, if Sam withdrew $1,500, he would receive "winner" status. This fact remains regardless of the reflections of account statements at the end of the scheme[189]—thus, even if Sam is owed $10,000 in fictitious profits, his recovery is still barred. To add insult to injury, in the situation where Sam is a winner, a clawback action may ensue to recover any amounts withdrawn above the principal

review of claims, reasoned that the correct decision was made because the courts must "balance the claims of individual investors against the requirements of a cost-effective and administratively efficient distribution." *Id.* at 336.

186. Picard notes that the activities include "evaluating claims, conducting forensic analysis of years of documents, working through complex negotiations, filing and responding to motions, assembling detailed complaints and litigating them." Picard, *supra* note 146.

187. Karen E. Nelson, *Turning Winners into Losers: Ponzi Scheme Avoidance Law and the Inequity of Clawbacks*, 38 MINN. L. REV. 1456, 1457 (2011).

188. *See* Wiand v. Buhl, No. 8:10-CV-75-T-17MAP, 2013 WL 12198453, at *11 (M.D. Fla. Jan. 11, 2013).

189. *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. at 135 (reasoning that "account statements are entirely fictitious, do not reflect actual securities positions that could be liquidated, and therefore cannot be relied upon to determine Net Equity.").

investment.[190] Taking it one step further, Sam could be deemed a bad faith investor exhibiting signs of willful blindness to red flags—a status upon which the trustee may require a return of both the profit and the principal investment.[191]

The discussion below outlines the clawback methods, which will explore the extent to which a transfer can be avoided and the availability of availing defenses. Here, the reader will see the importance of an investor's obligation to remain circumspect regarding red flags.[192] The preferential transfer provision will be covered first, followed by the fraudulent transfer provision and Uniform Fraudulent Transfer Acts. The stockbroker safe-harbor provision will be briefly examined. Upon completing that discussion, some discourse will be had with respect to arguments detailing what some believe to be an inequitable process. Challengers of the clawback process dispute the equitability when requiring "innocent" investors to reimburse other victims of a fraudulent scheme.[193] The stance of this Article will affirm prior courts' reasoning that (a) victims should share equally in the loss,[194] and (b) winning investors should not profit from iniquitous schemes, thereby legitimating the fraud.[195]

### A. Preferential Transfers

A trustee may avoid a transfer of an interest of the debtor in property to the extent the transfer is preferential, meaning that the transfer benefits one or more creditors but not those falling in the same class.[196] The thrust of preference statute provides parity for creditors dealing with the debtor during the debtor's financial downfall, preventing, on one hand, the extraction by creditors of

190. *Buhl*, 2013 WL 12198453, at *11.

191. *Id.* at *1. However, the receiver was unsuccessful in proving willful blindness because the investor was not "on actual notice of specific facts that demanded further inquiry." *Id.* at *12.

192. *In re Bernard L. Madoff Invest. Sec. LLC*, 424 B.R. at 113 (referencing the good-faith defense and bad-faith status, both of which incorporate the goal of keeping creditors on level ground).

193. *See, e.g.*, Amy J. Sepinwall, *Righting Others' Wrongs: A Critical Look at Clawbacks in Madoff-Type Ponzi Schemes and Other Frauds*, 78 BROOK. L. REV. 1 (2012); Nelson, *supra* note 187.

194. *In re Bernard L. Madoff Invest. Sec. LLC*, 424 B.R. at 142.

195. *Id.* at 136.

196. *See* 11 U.S.C. § 547(b).

payment from the distressed debtor, and, on the other, the tendency of debtors to make payments to preferred creditors to the detriment of others.[197] Preferential transfer claims fall under the Code in § 547, which lays out in pertinent part the following:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition; . . . and
>
> (5) that enables such creditor to receive more than such creditor would receive if—
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.[198]

Under § 547(g), the trustee must prove these elements by a preponderance of the evidence.[199] The party the trustee is pursuing for the clawback claim is held to be a "creditor" when that party has a right to payment from the balance in the debtor's account.[200] With Ponzi schemes, the antecedent debt and insolvency prongs are almost always satisfied. An antecedent debt arises when the

197. David M. Holliday, *Cause of Action in Bankruptcy Case for Avoidance of Preferential Transfer Under 11 U.S.C.A. § 547*, 43 CAUSES OF ACTION 2D 219 (SEPTEMBER 2024 UPDATE).
198. 11 U.S.C. § 547(b).
199. *Id.* § 547(g); Daly v. Simeone, (*In re* Carrozzella), 270 B.R. 325, 329 (Bankr. D. Conn. 2001).
200. *In re Carrozzella*, 270 B.R. at 329.

investor entrusts funds to the debtor-fraudster.[201] To rationalize this, it can be reasoned that the initial "investment" is, in all reality, akin to a loan to the fraudster that is used to pay off other creditors.[202] This creates an antecedent debt whereby the fraudster becomes liable.[203] As long as the trustee can establish that the transfer was made 90 days prepetition, insolvency is presumed pursuant to § 547(f).[204] Satisfying the final element, courts have held the transfer will typically enable the creditor to receive more than they would in a hypothetical liquidation under Chapter 7—note, this determination naturally requires a case-by-case analysis of the amount received and the total assets available to the trustee to pay on other claims.[205] Ultimately, the burden of proof is not arduous, such that the trustee may straightforwardly avoid transfers within 90 days of prepetition.

However, there are limited and oftentimes unavailing defenses at the creditor's disposal under § 547(c).[206] Two of these defenses have been implicated in Ponzi scheme liquidations: (a) the contemporaneous exchange for new value defense[207] and (b) the ordinary course of business defense.[208] The former is helpful to an extent, while the latter is futile.[209]

The circumstances under which the contemporaneous exchange for new value defense would arise become apparent when an investor invests new funds with the fraudster upon receiving full or partial redemption of their prior investment.[210] This may occur if the payment entices the investor or if the fraudster

201. *Finn*, 860 N.W.2d at 651 (stating "any legally enforceable right to payment against the debtor is sufficient to qualify as an antecedent debt.").

202. Thunderdome v. R.T. Milord Co. (*In re* Thunderdome Houston Ltd. P'ship), 2000 WL 889846, at *8 (Bankr. N.D. Ill. June 23, 2000).

203. *See In re Carrozzella*, 270 B.R. at 329.

204. 11 U.S.C. § 547(f).

205. *See, e.g.*, *In re Carrozzella*, 270 B.R. at 329.

206. *See, e.g.*, *In re M & L Bus. Mach. Co.,* 155 B.R. at 537.

207. 11 U.S.C. § 547(c)(4).

208. *Id.* § 547(c)(2).

209. To dispose of the ordinary course of business defense, courts hold that "the exception applies to payments by a real business, not to payments by a fake business" with the purpose of defrauding investors. As such, in the case of any Ponzi scheme, the ordinary course of business defense will fail. *In re* S. Indus. Banking Corp., 159 B.R. 224, 227 (Bankr. E.D. Tenn. 1993).

210. *See In re M & L Bus. Mach. Co.*, 155 B.R. at 539.

persuades the investor to reinvest.[211] A creditor will prevail under the new value defense if (1) the creditor extended new value to the debtor, (2) both parties intended the new value and reciprocal transfer to be contemporaneous, and (3) the exchange was actually contemporaneous.[212] If the creditor-investor can establish those three elements, the trustee cannot avoid the entire transfer under the preferences theory.[213]

The overriding dilemma for the trustee is not in establishing elements of preferential transfers nor facing the restricted defenses of creditors, but rather, the limitation is on recovery when considering the entirety of a Ponzi scheme. Far more transfers are likely to occur outside of the 90-day period, a fact that renders preferential transfers an inferior theory in comparison to the fraudulent transfer provision.[214] Both, however, are proffered in accordance with the fundamental bankruptcy policy of leveling the playing field among creditors.

### B. Fraudulent Transfers

Trustees in a Ponzi scheme liquidation may use state and federal fraudulent transfer laws.[215] Both are similar in many respects, with the state Uniform Fraudulent Transfers Acts mirroring much of the language as seen in § 548 of the Code.[216] With the primary purpose of preventing a debtor-fraudster from "stiffing" creditors by illegitimately disposing of property that should be available to creditors,[217] the operation of the fraudulent transfer section is grounded in equity. Although designed to enable the avoidance of a transfer if the transferee received value from

211. This does not appear to be a frequent occurrence, thereby emphasizing the unlikelihood of any successful defense when the trustee is recovering under the preferences provision.

212. Redmond v. CJD (*In re* Brooke Corp.), 536 B.R. 896, 908 (Bankr. D. Kan. 2015).

213. *Id.*

214. David R. Hague, *Expanding the Ponzi Scheme Presumption*, 64 DEPAUL L. REV. 867, 908 n.94 (2015).

215. John J. Monaghan et al., *Ponzi Schemes and Clawbacks: Investors Pay Twice for the Crimes of Others*, WILLAMETTE MANAGEMENT ASSOCIATES, 6 (2009), https://www.hklaw.com/-/media/files/insights/publications/2009/06/ponzi-schemes-and-clawbacks-investors-pay-twice-fo/files/ponzi-schemes-and-clawbacks-investors-pay-twice-fo/fileattachment/54301.pdf.

216. Grochocinski v. Zeigler (*In re* Zeigler), 320 B.R. 362, 372 (Bankr. N.D. Ill. 2005) (quoting Levit v. Spatz (*In re* Spatz), 222 B.R. 157, 164 (N.D. Ill. 1998)).

217. Davis v. California, (*In re* Venoco LLC), 998 F.3d 94, 105 n.12 (3rd Cir. 2021).

the debtor in excess of that given, "[i]t is not designed to turn every vendor into [an] insurer to creditors against corporate malfeasance."[218] The relevant portion reads as follows:

> (a)(1) The trustee may avoid any transfer . . . of an interest of the debtor in property . . . that was made . . . on or within 2 years [prepetition], if the debtor voluntarily or involuntarily—
>
> (A) made such transfer . . . with the actual intent to hinder, delay, or defraud [creditors]; or
>
> (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (ii)(I) was insolvent on the date that such transfer was made.[219]

Quite like an action under the preferential transfer provision, the trustee must establish the debtor-fraudster had an interest in the property being clawed back from the investor.[220] Courts do not hesitate to find that the debtor has an interest in any funds the investors entrusted to the Ponzi scheme.[221]

Subsections (A) and (B) are referred to as "actual fraud" and "constructive fraud," respectively. Both will be analyzed in turn, but please note, the trustee usually pursues fraudulent transfers under actual fraud in the context of Ponzi schemes for beneficial reasons detailed in the Ponzi Scheme Presumptions section below.

### *1. Constructive Fraud*

Causes of action brought under the Code § 548(a)(1)(B) require the trustee to employ a two-pronged approach.[222] First, the trustee must demonstrate that the debtor-fraudster was insolvent when

218. Peterson v. TTS Granite Inc., (*In re* Mack Indus., Ltd.), 622 B.R. 887, 895 (Bankr. N.D. Ill. 2020).

219. 11 U.S.C. § 548(a)(1).

220. Dicello v. Jenkins (*In re* Int'l Loan Network), 160 B.R. 1, 10 (Bankr. D.D.C. 1993).

221. *Id.* at 11 (stating "case law . . . unanimously indicates that funds transferred to investors in a Ponzi scheme are property of the debtor.") (citations omitted).

222. *See* Cuthill v. Greenmark, LLC (*In re* World Vision Ent., Inc.), 275 B.R. 641, 657 (Bankr. M.D. Fla. 2002). *See also* Bayou Superfund v. WAM Long/Short Fund (*In re* Bayou Group, LLC), 362 B.R. 624, 632 (Bankr. S.D.N.Y. 2007) ("[trustee] has the burden of pleading and proving that the debtor received less than reasonably equivalent value for the transfer, and also that the debtor was insolvent at the time of or was rendered insolvent by the transfer.").

the transfer was made.[223] The vast majority of courts adopt the insolvency presumption (covered below), essentially dictating that Ponzi schemes are "hopelessly insolvent from the commencement of its operations through the Petition Date"[224] because "promised rates of return . . . are in excess of any real investments."[225] Absent the insolvency presumption, the trustee undergoes time-intensive calculations to determine at what point the debtor's liabilities are greater than all of its assets.[226] This is a process that unnecessarily hinders the trustee's goal to quickly recover assets for equitable distribution, further underscoring the critical aspect of the presumptions. Moreover, under the distributive design of SIPA, many of the administrative costs and expenses to make such calculations will be absorbed at the expense of the creditors.[227]

Second, the trustee must show the transfer was made in exchange for less than reasonably equivalent value.[228] Courts consistently hold that the investor receives reasonably equivalent value to the extent of their principal investment—any amounts in excess are voidable as fraudulent transfers.[229] To justify the stance, courts proffer the often-relied-upon reasoning that any amounts in excess of the principal investment are fictitious profits, representing illegitimate investment activity, such that the profits could not be transferred in exchange for reasonably equivalent value.[230] Since those profits never actually existed, the trustee can proceed to recover the funds to the benefit of losing creditors.[231] Notably, the constructive fraud theory insulates a winner's principal investment unless the trustee can prove a lack of good faith, in which case the trustee may also recover the principal.[232]

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223. *See In re Bayou Group*, 362 B.R. at 632.
224. Rieser v. Hayslip (*In re* Canyon Systems Corp.), 343 B.R. 615, 649 (Bankr. S.D. Ohio 2006) (citing *In re* Carrozzella & Richardson, 286 B.R. 480, 486 n.17 (D. Conn. 2002)).
225. *Id.* (quoting *In re* Taubman, 160 B.R. 964, 978 (Bankr. S.D. Ohio 1993)).
226. *See In re Taubman*, 160 B.R. at 985-86.
227. *See* 15 U.S.C. § 78fff-2(c)(1).
228. *In re World Vision,* 275 B.R. at 657.
229. *Id.* (citing Balaber-Strauss v. Brokers (*In re* Churchill Mortg. Inv. Corp.), 256 B.R. 664, 680 (Bankr. S.D.N.Y. 2000)).
230. Donell v. Kowell, 533 F.3d 762, 772 (9th Cir. 2008).
231. *See e.g., id.*
232. *Id.* at 771.

### *2. Actual Fraud*

In contrast to the safeguards for principal investments under the constructive fraud theory, the actual fraud theory permits the trustee to recover the entire amount paid to the investor subject to certain defenses (which, realistically, will only permit the trustee to recover excess profits).[233] Actual fraud under the Code § 548(a)(1)(A) necessitates a showing of the debtor's actual intent to hinder, delay, or defraud creditors.[234] To facilitate the process and to avoid the burden of proving the express statutory elements, recent courts have concluded that any acts conducted in the furtherance of a Ponzi scheme are, by their nature, made with actual intent to hinder, delay, or defraud creditors.[235] This stance is deemed the "Ponzi scheme presumption." In the absence of the presumption, the trustee must prove actual fraud by direct evidence or by inference.[236] To do so, the trustee may show a confluence of the badges of fraud.[237]

The badges of fraud generally include, but are not limited to, the following factors gleaned from FUFTA: (1) the transfer or obligation was to an insider; (2) the debtor retained possession or control of the property transferred after the transfer; (3) the transfer or obligation was disclosed or concealed; (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; (5) the transfer was of substantially all the debtor's assets; (6) the debtor absconded; (7) the debtor removed or concealed assets; (8) the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (11) the debtor transferred the essential assets of the

233. *Id.*
234. 11 U.S.C. § 548(a)(1)(A).
235. Picard v. Estate of Igoin (*In re* Bernard L. Madoff Inv. Sec. LLC), 525 B.R. 871, 892 n.21 (Bankr. S.D.N.Y. 2015) (citing Bear, Stearns Sec. Corp. v. Gredd (*In re* Manhattan Inv. Fund Ltd.), 397 B.R. 1, 11 (S.D.N.Y. 2007)).
236. Kelley v. Opportunity Fin., LLC (*In re* Petters Co.), 550 B.R. 457, 467-68 (Bankr. D. Minn. 2016).
237. *Id.* at 468.

business to a lienor that transferred the assets to an insider of the debtor.[238]

Please note that no one factor is dispositive, and there are no clear rules specifying the number of factors that must be present for fraud to exist.[239] However, a number of badges will almost certainly be present in a Ponzi scheme (e.g., factors 5, 8-10), while others may not.

Establishing the badges of fraud entails more groundwork through additional discovery, calculations, and more, highlighting the relative significance of the Ponzi scheme presumption.[240] To require the trustee to prove all essential elements for each subject transfer, in situations where the trustee is pursuing a multitude of clawback claims, presents a direct hindrance to the entire purpose of the clawback action. As such, courts should maintain and promote the usage of the Ponzi scheme presumption.

Recovery under the actual fraud theory is subject to the good faith and for value defense under § 548(c) of the Code.[241]

### *3. Good Faith Defense*

To escape the prospect of surrendering the entire transfer, a transferee may rely on the following provision set forth in § 548(c): "a transferee . . . that takes for value and in good faith . . . may retain any interest transferred . . . to the extent that such transferee . . . gave value to the debtor in exchange."[242] As such, the transferee has the responsibility of proving (1) value was given for the transfers and (2) that it received the challenged transfer in good faith.[243] In the case of UFTA provisions, often this must be "reasonably equivalent value."[244]

First, as detailed previously, courts typically hold that an investor gives value up to the amount of the principal investment

238. FLA. STAT. § 726.105(2) (2023).

239. *See, e.g.*, *In re Ritz*, 567 B.R. 715, 740-41 (noting that "several of these 'badges of fraud' must be present," but also emphasizing that not even a majority of the badges must be present to show fraud exists).

240. Hague, *supra* note 214, at 868-69.

241. Donell v. Kowell, 533 F.3d 762, 771 (9th Cir. 2008). *See also* 11 U.S.C § 548(c).

242. 11 U.S.C. § 548(c).

243. Kapila v. Integra Bank (*In re* Pearlman), 440 B.R. 569, 576 (Bankr. M.D. Fla. 2010).

244. *Id.* at 574.

because the investor has an equitable claim to that amount.[245] The good faith defense extends to cover profits in excess of the principal.[246] Second, the investor must establish the "good faith" component, which is not defined in the Code or in many state statutes.[247] An objective standard has been established, looking not to whether the investor had mere subjective knowledge of the debtor's fraudulent purpose; but whether the investor was put on inquiry notice.[248] Under inquiry notice, the court must still consider whether the circumstances would have put an ordinarily prudent person in the investor's shoes upon notice to make an inquiry, and whether that inquiry, if diligently made, would have led to sufficient knowledge of the facts to show a fraudulent purpose at play.[249] Herein arises the need for investors to recognize red flags prior to making their investment. If the red flags are glaring, the investor may not be afforded the protections of the good faith defense.

#### *4. Bad Faith Investors*

For purposes of recovering the debtor's payment of excess profit and the principal investments in actually fraudulent transfers, trustees must plead the presence of "willful blindness" attributable to the investor.[250] Willful blindness returns the reader to the importance of red-flag recognition—an investor exhibits willful blindness when he chooses to blind himself to red flags indicating a high probability of fraud.[251]

245. Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 499 B.R. 416, 425-26 (Bankr. S.D.N.Y. 2013).

246. *See Donell*, 533 F.3d at 771.

247. *In re Pearlman*, 440 B.R. at 576.

248. Wiand v. Waxenberg, 611 F. Supp. 2d 1299, 1319 (M.D. Fla. 2009).

249. *Id.*

250. *See* Picard v. Avellino (*In re Bernard L. Madoff Inv. Sec.* LLC), 557 B.R. 89, 113 (Bankr. S.D.N.Y. 2016) (noting that "'willful blindness' to the truth is tantamount to a lack of good faith," which would, in turn, prohibit the use of the good faith defense to protect principal investments).

251. *Id.*

### C. Uniform Fraudulent Transfers Acts: Florida Uniform Fraudulent Transfer Act ("FUFTA")

UFTAs are applicable in Ponzi scheme liquidations and have been enacted in virtually every state.[252] Some states may adopt a Uniform Voidable Transactions Act ("UVTA"),[253] which is essentially the same as a UFTA. The trustee may target transfers using UFTA because of section 544(b) of the Code,[254] which reads that a trustee may avoid transfers that are voidable under state law by a creditor holding an unsecured claim.[255]

One such example is FUFTA, found in Chapter 726, Florida Statutes, which grants the trustee the power to avoid actually or constructively fraudulent transfers at the state level.[256] This paper will now examine FUFTA to give the reader insight into how these provisions operate.

Subsections 726.102-104 detail several definitions, importantly, including definitions for "value" and "insolvency" in the latter two subsections.[257] Subsection 726.105 parallels the actual and constructive fraud provisions found in the Code § 548 and further denotes the badges of fraud used to prove or indicate actual fraud.[258] Constructive fraud for present creditors is further detailed under subsection 726.106(1), which lays out the reasonably equivalent value and insolvency prong, and subsection 726.106(2), which covers transfers to insiders.[259] The good faith defense is covered in subsection 726.109(1).[260]

Most significantly, subsection 726.110 introduces the preeminent aspect of using UFTA provisions, the reach-back

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252. UNIF. FRAUDULENT TRANSFER ACT (UNIF. L. COMM'N 1984), https://www.uniformlaws.org/viewdocument/committee-archive-1984 (landing page for the archived Uniform Fraudulent Transfers Act).

253. As of April 2020, the UVTA was adopted by twenty-one states and introduced to four other states. Mark G. Douglas, *Uniform Voidable Transactions Act Adopted in New York*, JONES DAY (Apr. 2020), https://www.jonesday.com/en/insights/2020/04/uniform-voidable-transactions-act-adopted-in-new-y.

254. Donell v. Kowell, 533 F.3d 762, 775 n.7 (9th Cir. 2008) (stating that section 544(b) "authoriz[es] the trustee to recover fraudulent transfers under § 548 and also applicable state law.").

255. 11 U.S.C. § 544(b).

256. Wiand v. Morgan, 919 F. Supp. 2d 1342, 1354 (M.D. Fla. 2013).

257. FLA. STAT. § 726.103-104 (2024).

258. *Id.* § 726.105.

259. *Id.* § 726.106(1)–(2).

260. *Id.* § 726.109(1).

periods. In the case where the trustee is pursuing a claim under constructive fraud (not likely for Ponzi schemes), the clawback blankets any transfers made within four years of prepetition.[261] For fraudulent transfers, the trustee may reach back for any transfers made within four years of prepetition.[262] But that is not all. The trustee is not time-barred on claims made within one year after the fraudulent nature of the transfer was or could reasonably have been discovered.[263] Where Ponzi schemes arise, it appears the trustee will invariably bring claims under UFTA provisions to maximize the equitability of the process by recovering to the fullest extent practicable.

### D. Section 546(e) Stockbroker Safe Harbor

Some situations may require the trustee to rely solely on constructive fraud to clawback fraudulent transfers. Given the transferee meets myriad requirements to qualify, that transferee may subsequently rely on the stockbroker safe harbor provision, a lesser used defense found in the Code § 546(e), to escape liability under constructive fraud.[264] At bottom, the provision operates to bar avoidance of transfers in constructive fraud context, as it pertains to situations involving certain payments to specified individuals or entities.[265] The provision is extremely complex, but highly beneficial. Notwithstanding its benefits, the stockbroker safe harbor is another example of lengthy examinations the trustee may be required to undergo, which the reader should keep in mind in regard to the thesis of the Article. In relevant part, slightly simplified and summarized, it reads:

261. *Id.* § 726.110(2). Notably, the Uniform Fraudulent Conveyance Act ("UFCA"), a past version of UFTA, was still in effect in New York, Michigan, Minnesota, and Maine until as late as 2020. That particular version allowed for a six-year reach back but is no longer applicable law as those states replaced the law with UVTA. *See, e.g.*, Douglas, *supra* note 253.

262. FLA. STAT. § 726.110(1) (2024).

263. *Id.*; *see also In re* Kaufman & Roberts, Inc., 188 B.R. 309, 312 (Bankr. S.D. Fla. 1995) (holding that "Trustee was not time barred by Florida's statute of limitations from bringing fraudulent transfer claim" even though transfers occurred more than four years prepetition.).

264. *See generally* Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 476 B.R. 715 (S.D.N.Y. 2012), supplemented (May 15, 2012), *aff'd sub nom*. *In re* Bernard L. Madoff Inv. Sec. LLC, 773 F.3d 411 (2d Cir. 2014).

265. *Scope and Applicability*, 3A BANKR. SERVICE L. ED. § 32:198 (JULY 2024 UPDATE).

> Despite sections 544 (state law provisions), 547 (preferential transfers), and 548(a)(1)(B) (constructively fraudulent transfers), the trustee cannot avoid transfers that are "settlement payments" made by or to (*or to the benefit of*) a commodity broker, "stockbroker," or financial institution, or transfers to the same in connection with a "securities contract" or commodity contract—however, this defense does not apply to actually fraudulent transfers.[266]

Section 546(e) covers numerous areas and requires in-depth breakdowns of definitional sections to determine if a transfer qualifies for the protection. In relation to securities, the *Enron* court posited that a "settlement payment" is "the financial settling-up after a trade."[267] In doing so, the Seventh Circuit held that a settlement payment occurred when customers of a scheme turned over stock and received the proceeds.[268] Under the Code § 101(53A), "stockbroker" status requires the presence of "customers" in an environment where the potential stockbroker is "engaged in the business of effecting transactions in securities—(i) for the account of others; or (ii) with members of the general public, from or for such person's own account."[269] Lastly, a "securities contract" under § 741(7) is a contract for the purchase or sale of a security.[270]

Again, where trustees are pursuing Ponzi scheme clawback claims, an action to avoid transfers as constructively fraudulent is uncommon, but certainly not unheard of.[271] Given the definitional breakdown above, the stockbroker safe harbor appears to apply to many security-based Ponzi schemes and consequently provides the investor, if falling within the parameters of entities for whom the defense is available, another defense to add to the arsenal.[272]

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266. 11 U.S.C. § 546(e).

267. Peterson v. Somers Dublin Ltd., 729 F.3d 741, 749 (7th Cir. 2013).

268. *Id.*

269. 11 U.S.C. § 101(53A).

270. *Id.* § 741(7).

271. *See Peterson*, 729 F.3d at 744-45. *See also* Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 476 B.R. 715 (S.D.N.Y. 2012), supplemented (May 15, 2012), *aff'd sub nom. In re* Bernard L. Madoff Inv. Sec. LLC, 773 F.3d 411 (2d Cir. 2014).

272. In relation to the virtual currency Ponzi schemes, discussed above for the reader's understanding of the direction of Ponzi schemes, there arises the question of how cryptocurrency will be classified. If classified as stock or commodity, section 546(e) may become available for investor protection. The bankruptcy courts and business courts seem

### E. Equitability?

Many adversaries of the clawback process claim that clawbacks are, by their very nature, inequitable.[273] Contrary to the detractors' arguments, the discussion herein further underscores the relative importance of clawback restitution and presumptions where so-called "innocent winners" have acquired the excess profit from the net losers. Shortly after this discussion, given all the background covered, the reader will be prepared to delve into the significance of Ponzi scheme presumptions.

The fairness and morality of the clawback processes are often questioned by legal scholars, but those arguments simply do not overcome the breadth of logical reasoning behind the allowance of clawbacks.[274] Those scholars argue that innocent "winners" should not be required to mend the fraudster's wrongdoing by compensating the victims.[275] Intuitively, this argument makes sense. However, both the innocent winners and the losers are victims of fraud regardless of whether they escaped with profit or loss.[276] So, this begs the question, why should recovery provisions extend to innocent beneficiaries?

Considering as a baseline the business model of a Ponzi scheme—namely, that initial investors are paid with the funds of later investors[277]—it is evident that any profit a winner walks away with is composed of funds entrusted to the debtor by subsequent investors.[278] Allowing the winning investor to retain the profit would "credit the fraud and legitimize the phantom world created by [the fraudster]."[279] Further, courts have held that the fact that both the winners and losers are innocent in a Ponzi scheme "call[s] strongly for the principle that equality is equity."[280]

hesitant to apply a concrete definition, as classification may have far-reaching implications—as of 2021, the caselaw is sparse. This will be an interesting concept to follow.

273. *See generally* Sepinwall, *supra* note 193, at 17; Nelson, *supra* note 187, at 1468.

274. *See* Sepinwall, *supra* note 193, at 16-17.

275. *Id.*; *see also* Nelson, *supra* note 187, at 1471-74.

276. Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (*In re* Bernard L. Madoff Inv. Sec. LLC), 424 B.R 122, 142 (Bankr. S.D.N.Y. 2010).

277. Wiand v. Lee, 753 F.3d 1194, 1201 (11th Cir. 2014).

278. *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. at 142.

279. *Id.* at 140.

280. *Id.* at 142 (quoting *Cunningham*, 44 S. Ct. at 427).

Under circumstances where equality is called for, the clawbacks play a critical role in returning the greatest number of investors to their positions prior to the Ponzi scheme.[281] This leveling of the playing field for creditors, as previously mentioned, is one of the essential concepts underlying bankruptcy proceedings.[282]

The reader should now have a strong grasp of Ponzi schemes, SIPA, proper clawback claims, and the theories of recovery, as well as the important role that each play in reaching the conclusion that the clawback process calls for expeditiousness and fairness. As the framework has now been laid, the Article will turn to the overall thesis.

## *IX. THE PONZI SCHEME PRESUMPTION*

Time and time again the goal of the Ponzi scheme clawback process is underscored through the actions of the trustee—the fair distribution of the liquidated and recovered assets. To that end, the liquidating trustee's duty is akin to that of a bankruptcy trustee in collecting property "as expeditiously as is compatible with the best interests of [the] parties in interest"—a crucial component of righting the debtor's wrongs.[283] As a matter of fact, that is the first listed duty of the trustee as prescribed by the Code, hammering down the significance of speed.[284]

With the need for efficiency in mind, the trustee faces a daunting burden when contemplating hundreds, if not thousands, of clawback suits with limited time and resources.[285] From this need, the seeds of the judicially created "Ponzi-scheme presumption" were sown.

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281. The goal should be to "bring[] the greatest number of investors closest to their positions prior to [the] scheme in an effort to make them whole." *In re Bernard L. Madoff Inv. Sec. LLC*, 424 B.R. at 142.

282. *Id.* (quoting "Net Winners and Net Losers . . . should not be treated disparately").

283. 11 U.S.C. § 704(a)(1).

284. *Id.*

285. Erik Larson and Christopher Cannon, *Madoff's Victims are Close to Getting their $19 Billion Back*, BLOOMBERG (Dec. 8, 2018), https://www.bloomberg.com/graphics/2018-recovering-madoff-money/.

## A. The Presumption

Absent the Ponzi scheme presumption, the trustee must plead and prove a confluence of the badges of fraud exists.[286] As mentioned, this can be an arduous, almost mathematical undertaking to determine whether the transfer was made in violation of creditor rights.[287] While this is a heavy burden, it is not the sole burdensome element. Often, the trustee must also demonstrate insolvency; another mathematical determination of whether, and at what point, the debtor's liabilities surpass its overall assets.[288] Although other evidentiary impediments do exist, the final notable and consistent burden on the trustee is establishing that the transfer was not made in exchange for reasonably equivalent value.[289] In the case of a classic Ponzi scheme, all of these requirements will typically be met, albeit at a timely expense. From this context arose the new rule known ubiquitously as the Ponzi scheme presumption.[290]

The Ponzi scheme presumption entails that such a scheme "demonstrates 'actual intent' as [a] matter of law because 'transfers made in the course of a Ponzi scheme could have been made for no purpose other than to hinder, delay or defraud creditors.'"[291] A review of federal and state authority on the presumption provides three components: (1) the intent of the transferor; (2) the transferor's solvency at the time of the transfer; and (3) whether the transferor received a reasonably equivalent value for the payment made to an investor.[292]

### *1. Actual Intent Presumption*

The "actual intent" aspect is clearly delineated in the courts' definition of the presumption—the purpose of a fraudster's acts in

286. *In re* Petters Co., 550 B.R. 457, 468 (Bankr. D. Minn. 2016).
287. Picard, *supra* note 146.
288. Rieser v. Hayslip (*In re* Canyon Systems Corp.), 343 B.R. 615, 647 (Bankr. S.D. Ohio 2006).
289. *Id.* at 639.
290. Bear, Stearns Sec. Corp. v. Gredd (*In re* Manhattan Inv. Fund Ltd.), 397 B.R. 1, 11 (S.D.N.Y. 2007).
291. Picard v. Estate of Igoin (*In re* Bernard L. Madoff Inv. Sec. LLC), 525 B.R. 871, 892 n.21 (Bankr. S.D.N.Y. 2015) (citing *In re Manhattan Inv. Fund Ltd.*, 397 B.R at 8).
292. Finn v. All. Bank, 860 N.W.2d 638, 645-46 (Minn. 2015).

a Ponzi scheme is to profit by defrauding creditors.[293] Importantly, this inherently includes the requirement that the existence of a Ponzi scheme be first established.[294] Once established, the trustee may streamline the recovery process by undercutting the procedural hurdles posed by the badges of fraud.[295] This presumption makes sense both intuitively and when considering the efficiency required during the clawback processes. The maintenance of this presumption by most courts shows a concurrence of legal opinion made with the best interest of administration in mind.[296] To overturn this presumption would require a change in the core definition of what it means to operate a Ponzi scheme.

### *2. Insolvency Presumption*

Upon finding the existence of a Ponzi scheme, a plaintiff benefits, as does the trustee and other victimized creditors, through an automatic establishment, by way of the Ponzi scheme presumption, of the insolvency of the debtor-fraudster.[297] Covered above, insolvency is a component required to be established in the constructive fraud context.[298] Maintenance of the Ponzi scheme presumption as it relates to insolvency is crucial, as it pares down the efforts the trustee must undergo to prove such critical element under section 548 claims.

The Second Circuit offers a definition of "Ponzi scheme" that sheds light on the insolvency component of the presumption:

> A [P]onzi scheme is a scheme whereby a corporation operates and continues to operate at a loss . . . [and] [t]he effect of such a scheme is to put the corporation farther and farther into debt

293. Picard v. Citibank, N.A. (*In re* Bernard L. Madoff Inv. Sec. LLC), 12 F.4th 171, 181 (2d Cir. 2021).

294. *See* Bauman v. Bliese (*In re* McCarn's Allstate Fin., Inc.), 326 B.R. 843, 850 (Bankr. M.D. Fla. 2005) ("[B]ankruptcy courts nationwide have recognized that establishing the existence of a Ponzi scheme is sufficient to prove a Debtor's actual intent to defraud.").

295. *See Finn*, 860 N.W.2d at 647 (noting that the trustee may use the badges of fraud to prove actual intent if the presumption is disallowed).

296. Bell v. Disner, 2016 WL 7007522, at *10 (W.D.N.C. Nov. 29, 2016) ("The 'Ponzi scheme presumption' has been long settled in a number of jurisdictions and under an analogous section of the Bankruptcy Code.").

297. Pergament v. Torac Realty, LLC (*In re* Diamond Fin. Co.), 658 B.R. 748, 766 (Bankr. E.D.N.Y. 2024).

298. *Id.*

> by incurring more and more liability and to give the corporation the false appearance of profitability in order to obtain new investors.[299]

One of the cornerstones of Ponzi schemes is the idea that the scheme is insolvent from its inception, an idea that is incorporated in the presumption;[300] and, further, an idea that can be traced back to the original Ponzi case, *Cunningham v. Brown*, in 1924,[301] where the Supreme Court found that Ponzi "was always insolvent, and became daily more so, the more his business succeeded."[302] Once more, creating this presumption is a completely logical step, as requiring the trustee to undergo inexpedient measures to prove a core understanding of Ponzi schemes inhibits the goal of an equitable process.

### *3. Reasonably Equivalent Value Presumption*

Under the final leg of the presumption, courts hold "reasonably equivalent value" to be lacking for any amounts exceeding the return of the principal investment.[303] The argument here follows along similar guidelines established in prior sections of this Article. The satisfaction of a preexisting debt (the return of principal investment entrusted to the debtor) constitutes a dollar-for-dollar transfer of reasonably equivalent value.[304] Nevertheless, any amounts transferred in excess cannot be for reasonably equivalent value because those amounts are fictitious profits; thus, effectively limiting the good faith defense in UFTA situations and propping up the proof of constructive fraud.[305] This provides a well-established, and significant, pleading advantage and advances the fairness and expediency goals of the process.

299. Janvey v. Alguire, 647 F.3d 585, 597 (5th Cir. 2011) (quoting Hirsch v. Arthur Andersen & Co., 72 F.3d 1085, 1088 n.3 (2d Cir. 1995)).

300. Warfield v. Byron, 436 F.3d 551, 558 (5th Cir. 2006) (citing *Cunningham*, 44 S. Ct. at 428).

301. *Id.*

302. *Cunningham*, 44 S. Ct. at 425.

303. *See, e.g.*, *In re* AFI Holding, Inc., 525 F.3d 700, 708-9 (9th Cir. 2008).

304. *In re* Carrozzella & Richardson, 286 B.R. 480, 486 (D. Conn. 2002).

305. Picard v. Madoff (*In re* Bernard L. Madoff Inv. Sec. LLC), 458 B.R. 87, 112 (Bankr. S.D.N.Y. 2011).

## B. State Court Rejection

The fluid and efficient process established with the creation of the Ponzi scheme presumption faces an attack led by the Minnesota Supreme Court.[306] While the disagreement centers around the massive Petters Company, Inc. ("PCI") Ponzi scheme clawbacks, it finds its bearings in a relatively unknown lawsuit, *Finn v. Alliance Bank*, against the First United Funding ("FUF") Ponzi scheme.[307] The salient ruling in *Finn* rejects all three components of the Ponzi scheme presumption; instead, holding that the trustee must prove the express statutory elements in the Minnesota Uniform Fraudulent Transfer Act ("MUFTA") because "MUFTA does not contain a provision allowing a court to presume anything based on the mere existence of a Ponzi scheme."[308]

An interesting case, *Finn* presented a Ponzi scheme rooted in both legitimate and fraudulent transactions—"some existing and the rest bogus."[309] The FUF scheme can be broken down into two parts: (1) conducting genuine business in the real estate finance industry, and (2) attracting lenders to "participate in" the loans.[310] The receiver sought to recover transfers to loan participants, contending that the Ponzi scheme presumption must be given conclusive effect by applying it to the case at hand.[311] The *Finn* court in rejecting the presumption stated:

> [T]he focus of the statute is on individual transfers, rather than a pattern of transactions that are part of a greater "scheme." . . . The asset-by-asset and transfer-by-transfer nature of the inquiry under MUFTA requires a creditor to prove the elements of a fraudulent transfer with respect to each transfer, rather than relying on a presumption related to the form or structure of the entity making the transfer.[312]

Further, the court focused on the specific language in MUFTA, noting that the statute does not define "Ponzi scheme" nor does it

306. Finn v. All. Bank, 860 N.W. 2d. 638, 648 (Minn. 2015).
307. *Id.* at 642.
308. *Id.* at 646-7.
309. Kelley v. Opportunity Fin., LLC (*In re* Petters Co.), 550 B.R. 457, 463 (Bankr. D. Minn. 2016).
310. *Id.* at 464.
311. *Finn*, 860 N.W. 2d at 648.
312. *Id.* at 647.

contain a provision allowing presumptions on the basis of a Ponzi scheme's presence.[313] The court highlighted the list of badges of fraud found in MUFTA, insinuating that the existence of those badges necessarily negates an interpretation that one unlisted factor, the presence of a Ponzi scheme, can be conclusive.[314] Similar reasoning was used to justify the rejection of the insolvency component—that the presumption was not defined in statute and the court will not "add language to MUFTA."[315] As to the third component of the presumption, the court refers once more to express language.[316] By the court's reasoning, the lack of reasonably equivalent value is an element of proof in the claim, and the statute lists specific kinds of reasonably equivalent value that must be proven.[317]

Patrick Finn, the receiver in the case, proffered policy arguments centered around the fairness and policy justifications requiring the allowance of the presumptions.[318] First, Finn argued that public policy renders all transactions between the fraudster and victims to be unenforceable.[319] Second, the Ponzi scheme presumptions operate as a vehicle to ensure fair and equitable treatment of all creditors.[320] In rejecting the first argument, the court speculates that not every scheme lacks a legitimate source of earnings.[321] In effect that because FUF had a legitimate business operation, it likewise had a legitimate source of earnings.[322] Therefore, some of the contracts are enforceable as a matter of law. Regarding the second argument, the court argues that "MUFTA does not prohibit a debtor from making a preferential transfer in favor of one bona fide creditor over another, so long as the transfer is not fraudulent."[323] Essentially, not all creditors require equal treatment.[324]

313. *Id.* at 646-647.
314. *Id.* at 647.
315. Finn v. All. Bank, 860 N.W. 2d. 638, 648 (Minn. 2015).
316. *Id.* at 650.
317. *Id.*
318. *See, e.g.*, *id.* at 653.
319. *Id.* at 651.
320. *Id.* at 652-653.
321. Finn v. All. Bank, 860 N.W. 2d. 638, 652 (Minn. 2015).
322. *See id.*
323. *Id.* at 653.
324. *Id.* at 652 (stating that "equality among a debtor's creditors, even if they are victims of a Ponzi scheme, is not the purpose of MUFTA.").

*Finn* represents the instance where a Ponzi scheme falls within a broader operation that is legitimate.[325] Nevertheless, the comprehensive rejection of the Ponzi scheme presumption has a carryover effect by impacting other Ponzi scheme cases under MUFTA.[326] As the presumptions in *Finn* were undergoing judicial scrutiny, the PCI clawback cases were entering their initial stages.[327] On the proverbial eve of the PCI litigation, *Finn* was decided.[328] The *Finn* decision led to a massive overhaul of the PCI cases, where the Minnesota bankruptcy courts had just previously allowed the presumption to be included.[329] A series of rulings citing *Finn* ensued, effectively overturning prior rulings that allowed the receiver to use the presumption.[330]

Merely a year after the *Finn* ruling, the Texas Supreme Court similarly rejected the presumption in one of the numerous Stanford Ponzi-scheme-clawback cases.[331] *Janvey v. Golf Channel* is rather novel, as it stood to be the first federal case certified to a state's supreme court, requiring an interpretation of UFTA.[332] Specifically, the case focused on the "value" and "reasonably equivalent value" factors of the Texas Uniform Fraudulent Transfer Act ("TUFTA").[333] The relevant transfer was for $5.9 million from the Stanford operation to The Golf Channel in return for commercial promotions.[334] The receiver sought to avoid the transfer by relying upon the Ponzi scheme presumption.[335] Ultimately, The Golf Channel was absolved of any obligation to return the transfer.[336] In coming to this conclusion, the Texas Supreme Court, much like the Minnesota Supreme Court before it, noted that the specific language in TUFTA did not require or

325. *See id.* at 652.
326. *See, e.g.*, *In re Petters Co.*, 550 B.R. 457.
327. *Finn*, 860 N.W.2d at 642.
328. *Id.*
329. *See, e.g.*, *id.*
330. *See, e.g.*, *In re Petters Co.*, 550 B.R. 457 at 465; *see also* Lariat Co.'s v. Wigley, A17-0210, 2020 WL 5507811, at *6 (Minn. Ct. App. Sept. 14, 2020); Stoebner v. Opportunity Fin., LLC, 909 F.3d 219, 223 (8th Cir. 2018).
331. Janvey v. Golf Channel, Inc., 487 S.W.3d 560 (Tex. 2016).
332. Fox Rothschild LLP, *For The Defense: State Courts Reject The Ponzi Scheme Presumptions In Fraudulent Transfer Actions*, JD SUPRA (Aug. 7, 2018), https://www.jdsupra.com/legalnews/for-the-defense-state-courts-reject-the-84282/.
333. *Janvey*, 487 S.W.3d at 581.
334. *Id.* at 562.
335. *Id.* at 565.
336. *Id.* at 582.

permit the court to apply a different standard of interpretation when dealing with Ponzi schemes.[337]

### C. The Presumption Must Continue

Presumptions are a crucial element of judiciary framework.[338] In essence, a presumption generates an exception to typical standards of proof (e.g., the badges of fraud) "by encouraging one fact to be inferred from another."[339] Once the plaintiff has proven A (e.g., the existence of the Ponzi scheme), then B must be presumed (e.g., the scheme was insolvent from inception).[340] As such, a "presumption does not operate independently of evidence"; rather, it requires a consideration of "the facts and circumstances to determine . . . the natural and necessary consequences of those acts."[341] Here, once the existence of a Ponzi scheme is established using an evidentiary standard, the entire process is consequentially simplified by requiring the presumption that any acts in furtherance of a Ponzi scheme incur insolvency and are made with actual intent.[342]

There are instances where the result may be considered inequitable (such as *Finn* and *Golf Channel*), but the Ponzi presumption falls in line with the fundamental task of fraudulent transfer law—that is, "to protect creditors from debtors' attempts" to transfer property outside the grasp of creditors.[343] The presumption effectively allows the trustee to execute its duties in the most effective and streamlined manner possible.[344] Once a Ponzi scheme's existence is proven, the "summary judgment burden is conclusively established" and will allow the trustee to proceed against the mass of net winners.[345] An occasional procedural hiccup may occur as the burden to establish defenses shifts to the net winners, but ultimately the trustee will have a

337. *Id.*
338. *See* John Calvin Jeffries, Jr. & Paul B. Stephan III, *Defenses, Presumptions, and Burden of Proof in the Criminal Law*, 88 YALE L.J. 1325, 1387–88 (1979).
339. *Id.* at 1388.
340. Connecticut v. Johnson, 460 U.S. 73, 96 (1983) (Powell, J., dissenting).
341. *Id.* at 96–97.
342. Hague, *supra* note 214, at 885–86.
343. *Id.* at 868.
344. *See id.* at 869.
345. *Id.*

claim to any excess profits above the principal investment. Accordingly, the trustee's recovery process operates like a finely tuned machine. Disposal of the presumption will throw a wrench into that machine.

A departure from the presumption will result in the arduous, timely, and costly examination of individual transfers.[346] The result defeats the trustee's goal of executing these proceedings expeditiously.[347] Moreover, the large costs associated with these proceedings will prove detrimental to the estate when considering a cost-benefit analysis.[348] Returning to the SIPA distribution scheme, the highest priority is the repayment of advances partially in the form of administrative costs and expenses.[349] As such, the substantial costs in the absence of the presumptions will eventually be absorbed by the victims seeking financial recovery. This results in an inequitable outcome that is not in conformity with the goal of the bankruptcy proceedings, the duties of the trustee, or the overall purpose of a fraudulent transfer act.

How might the court remedy the conflicting positions of (1) the creditors caught up in a partially legitimate scheme and (2) the losing creditors requiring restitution? The answer is certainly not disposing of the presumption in its entirety. Rather, the presumption must remain intact to grant the trustee a procedural vehicle with which he can bypass proving the time-consuming statutory elements.[350] The first step is encoding the Ponzi scheme presumption within the UFTA statutes, including a universal definition of "Ponzi scheme."[351] By clearly delineating the circumstances which afford the presumption, the courts will have clear guidelines to follow.[352] However, a carefully crafted exception should likewise be incorporated where the defendant-creditor is provided a defense similar to those seen in § 548(c) of the Code and relative UFTA provisions. This exception should be burden shifting, requiring the defendant rather than the plaintiff-trustee

346. *See, e.g.*, *Finn*, 860 N.W.2d at 647.
347. 11 U.S.C. § 704(a)(1).
348. *See* 15 U.S.C. § 78fff-2(c)(1)(A).
349. *Id.*
350. *See* Hague, *supra* note 214, at 868–69.
351. *See Finn*, 860 N.W.2d at 646 (noting the MUFTA does not define "Ponzi scheme").
352. *See id.*

to prove the suspect transfer was wholly encompassed within a legitimate portion of the scheme.[353]

The proffered solution presents a fair balance of the needs of the trustee in meeting legislative and statutorily provided goals, and of creditors dealing with legitimate transactions within an illegitimate Ponzi scheme. In *Finn* and *Golf Channel*, the results were necessitated by the nature of the transactions; however, the court was left with no means to except those transfers other than by invalidating the Ponzi scheme presumption as a whole.[354] An overhaul of the provision would remedy the issues identified by those courts, respectively.

Further, by incorporating the suggested solution, the courts will remain in line with the public policy goals discussed in *Finn*.[355] First, all transactions related to the illegitimate part of the scheme will remain unenforceable. The first public policy concern relates specifically to any actions that will harm other creditors in furtherance of a fraudulent scheme. Arguably, some resistance might appear as those transactions may still include victimized creditors' funds. For example, the payment for commercial advertising in *Golf Channel* could reasonably stem from funds entrusted to the Stanford Ponzi scheme. However, a balance must be struck where the creditor is not participating in the material aspect of the scheme—i.e., investing in the scheme itself. If the creditor can sufficiently prove that funding or the substance of the transfer stemmed from a legitimate portion of the enterprise, that creditor should be allowed to retain the legitimate results of the transaction. In applying this, the *Golf Channel* decision would hold so long as the $5.9 million could be traced to a legitimate portion of the scheme—a portion free of victimized creditors' funds. If this cannot be accomplished, the transfer should be: (1) deemed to stem from an illegitimate portion of the enterprise; and (2) subsequently avoided and returned to the estate.

Second, by maintaining the true force of the presumption, all creditors involved in the Ponzi scheme will receive a fair and

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353. Putting the burden on the defending creditor may reduce some of the administrative costs and expenses.

354. *In re Petters Co.*, 550 B.R. at 464 ("It was inevitable that the *Finn* court's discussion, tone, analysis, and conclusions about the Ponzi scheme presumptions were channeled by the specific structure and operation of the Ponzi scheme before it.").

355. *Finn*, 860 N.W.2d at 651–52.

equitable result.[356] Accordingly, if a creditor can prove a transfer originated in legitimate business, then the claim may be discharged. Notwithstanding the discharge, the presumption will still remain for those involved in the Ponzi scheme itself. This ensures the process continues swiftly while simultaneously providing a just result for all parties involved.

The courts must refrain from disposing of the presumption or the result will be the demise of an equitable and necessary process. Instead, legislatures must act by integrating a uniform provision into UFTA detailing when the Ponzi scheme presumption arise and the technical elements that may be present to except a transfer from the trustee's claws. In doing so, the equitable results may continue to proceed.

## *X. CONCLUSION*

Ponzi schemes are the vehicles from which massive fraud is perpetrated.[357] By using complex tactics and mischievous ploys, fraudsters unleash havoc on the financial stability of innocent investors.[358] While some may win and some may lose, in the aftermath, restitution must necessarily ensue.[359] The key to leveling the playing field among the fraudsters' creditors lands in the hands of the trustee, who must utilize their time and resources to expeditiously claw back any fictitious profits.[360] The trustee may do so by proving the presence of preferential transfers, actually fraudulent transfers, or constructively fraudulent transfers using the avoidance provisions found within the Code and state UFTA provisions.[361]

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356. *See id.* at 653 (noting Finn's arguments regarding the "unfairness of allowing some creditors to profit at the expense of others.").

357. *See, e.g.*, U.S. v. Stanford, 805 F.3d 557, 564 (5th Cir. 2015); *see also* U.S. v. Petters, 663 F.3d 375, 379 (8th Cir. 2011).

358. *See, e.g.*, Sec. Inv. Prot. v. Madoff (*In re* Bernard L. Madoff Inv. Sec. LLC), 424 B.R. 122, 129–30 (Bankr. S.D. N.Y. 2010) (discussing Madoff's "Split-Strike Conversion Strategy").

359. To some, it may appear unfair that the more fortunate innocent investors relinquish their winnings to pay the losing investors. The reader should harken back to previous discussions that establish the true source of the winners' profits—losing investors' investments. When the debtor's estate can no longer pay, restitution must have some other origin, and the winners fill that role.

360. 11 U.S.C. § 704(a)(1).

361. Monaghan et al., *supra* note 215, at 5–6.

Preferential transfer provisions are advantageous to the extent they fall within 90-day reach-back period prescribed by the Code.[362] As such, many trustees seek to prove transfers fall in the realm of actual or constructive fraud. Proving either through the express statutory elements is a laborious and costly endeavor made at the expense of victimized creditors.[363] To avoid the administrative burden in favor of public policy and fairness to creditors, the majority of courts recognize a three-part Ponzi scheme presumption that allows the trustee to subvert the evidentiary process.[364] In recent years, the presumption has faced a handful of precarious rulings.[365] Given the split in rulings and the presumptions' uncertain future, the time is now for the legislatures to step in and encode the guidelines for Ponzi scheme presumption to ensure equitably for all.

362. *See* 11 U.S.C. § 547(b)(4)(A).
363. Hague, *supra* note 214, at 868–69.
364. *Finn*, 860 N.W.2d at 642.
365. *See id.*; Janvey v. Golf Channel, Inc., 487 S.W.3d 560 (Tex. 2016).