



AMERICAN
BANKRUPTCY
INSTITUTE

2019 Annual Spring Meeting

American Crime Stories: Unusual Fraudulent Conveyances, Insider Transactions and Outright Fraud

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AMERICAN CRIME STORIES:

Unusual Fraudulent Transfers, Insider Transactions and Outright Fraud

Panelists

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ABI 2019 Annual Spring Conference
April 2019, Washington, D.C.

Trustee's Checklist for a Fraud Case¹

- I. Pre-Appointment: Developing Game Plan
 - A. The Initial Steps
 - Conflicts check
 - Investigation
 - Public records search
 - Social media
 - Pending litigation
 - B. Gathering the Team
 - Clear calendars of key staff members and professionals
 - Evaluate prospects of case
 - Select outside professionals
 - Meet with new team to strategize
 - C. Preparing for Risks
 - Prepare to hold the assets, documents and other evidence still
 - Contact private security firm
 - Contact US Marshall service
 - Coordinate locksmiths
 - Evaluate pending criminal or other regulatory proceedings for possible interference
 - Prepare to take videographer and computer forensics team to the takeover to document current state of affairs
 - Plan on someone stealing assets or records because it will happen; take every precaution
- II. First Day Issues
 - A. Securing the Assets
 - Assign each member of the team tasks in advance
 - Secure assets
 - Contain employees, prevent removal of records or assets
 - Obtain passwords
 - Interview key employees
 - Communicate with landlord, vendors, customers

¹ This checklist is intended to be an issue-spotting aid in a fraud case and is not intended to be a comprehensive list of all actions to be taken by a trustee in connection with a bankruptcy or fraud case.

- Identify and visit any storage facility; research payables for any offsite storage facilities
- Time the entry onto the premises
- Secure the premises
 - Doors and windows
 - Computers and passwords
 - Mail
 - Ensure remote access to computers is restricted

- B. The Initial Interviews
 - When and where
 - Employee questionnaires
 - Personal property
 - Transfers of cash or property
 - Location of assets
 - Knowledge of wrongdoing

- C. Notice of Bankruptcy
 - To financial institutions regarding asset freeze
 - Bank, brokerage, investment accounts
 - Credit card processing companies
 - To employees, vendors, landlords and other key parties
 - To investors/website
 - Hand out certified copies of bankruptcy petition
 - Contact landlord
 - Post notice at all facilities of Debtor

- D. Preserving Evidence
 - Video premises on first day
 - Check desk drawers and trash receptacles
 - Diagram and tag offices, file cabinets and documents
 - Locate and preserve back up tapes and off-site storage facilities including colocation facilities
 - Obtain all company property from employees, including laptops and phones
 - Obtain website and email hosting information and preserve data
 - Consider if litigation hold notice is appropriate, especially if operations or employees may continue

III. Operational Issues

- A. Immediate Operational Issues
 - Transfer utilities
 - Identify recurring expenses to preserve necessary ones and terminate unnecessary
 - Evaluate relocating employees or documents
 - Open new operating accounts
 - Evaluate payroll and insurance
 - Terminate unnecessary employees and benefits
- B. Longer Term Operational Issues
 - Maintain property
 - Continue or locate management company
 - Obtain assistance of key employees
 - Evaluate leased equipment
 - Evaluate any ancillary businesses
 - Monitor cash flow
 - Review credit card bills
 - Work with building security

IV. Communications

- A. Communication with Investors
 - Open lines of communication
 - Appoint communication liaison to field inquiries
 - Create website
 - Prepare FAQs for website
 - Prepare quarterly updates
 - Post status reports, relevant articles and pleadings
- B. Communication with Employees, Vendors, and Others
 - Employees
 - Vendors and customers
 - Court
 - Media
 - Prepare email distribution list
 - Prepare reports for the investors and Court

V. Immediate Accounting Issues

- Take control of both electronic and hard copy accounting records
- Evaluate cash requirement and develop plan to fund expenses
- Review bank activity
- Review financial statements
- Obtain W-2 forms and 1099's
- Determine vendor balances
- Establish estate books and accounting system
- File Form 56 with Internal Revenue Service (Note Concerning Fiduciary Relationship) if appropriate

VI. Asset Identification

A. Using Financial and Other Records to Locate Assets

- Locate all bank accounts, subpoena records if necessary
- Review bank activity
- Identify lease agreements, identify leased items
- Review most current financial statements
- Search receivable and payment records for any diverted accounts receivable payments
- Send letters to all vendors that indicate credit balances on monthly statements and request refunds.
- Review any prepaid accounts and pursue recovery
- Review payments made for pre-paid expenses and attempt to recover expenses if appropriate.
- Review status of all retainers paid to legal counsel and other professionals.
- Review and recover utility deposits.
- Review and determine any possible recovery from landlord security deposits
- Review Fed-Ex, UPS and other delivery service invoices from Defendant's offices to determine if there may be unauthorized asset transfers shipped directly from the Debtor's offices
- Determine if company has any automobiles and where located
- Research information regarding intellectual property and market these assets.
- Review all insurance riders for specific assets
- Review partial membership interests in LLC's
- Consider that Debtor may have Bitcoins or other cryptocurrency and search electronic records for information on "bitcoins" and inquire about in depositions

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- Review any recent divorce agreements to search for asset transferred to spouse for asset protection purposes
- Review all trust agreements to search for assets transferred in asset protection trusts
- Research domain names owned by Debtor and determine if there are additional domains that continue to operate.
- Evaluate whether any assets have been transferred and are recoverable as fraudulent transfers
- Determine if there are perfected security interests in any of the assets
- Search for information regarding any liens filed against the prospective defendant, i.e., UCC's, judgments, etc.

B. Accounting - Forensic Accounting

- Create data base of sources and uses of funds
- Prepare funds tracing database of all cash transactions
- Prepare insolvency analysis
- Consider possible tax refunds for taxes paid on fraud income, status of net operating losses, other potential tax benefits

C. Electronic Data Discovery

- Immediately secure all on-site and cloud-based servers
- Contact internet/email service providers and capture emails hosted on other servers
- Make images of phones with emails, text messages, social media communications if Debtor's property
- Contact website provider to change password
- Image mainframe computers and networks and develop method to safeguard while providing access to data - image before accessing data
- Utilize forensic data recovery software to review erased files of key computers
- Beware of privacy consideration and privileged information
- Take appropriate precautions to protect all data and have office systems and firewalls checked and upgraded
- Print all documents still loaded into memory on copiers and faxes.
- Arrange to have all recorded voice mails from every phone saved. Cut off access to phones and voice mail from other parties

VII. Turning It Into Cash

A. Asset Disposition

- Arrange to have all physical assets identified and secured
- Prepare detailed inventory of all assets as of the date of appointment.

- Obtain appraisals on all real property to be sold
- Evaluate any liens or competing claims to property
- Determine whether to employ broker or sell by auction
- Verify all machinery and equipment is operating at time of sale
- Advise liquidation team and auctioneers not to sell the file cabinets and key computers that need to be retained by the Trustee
- Determine date of expiration of trademarks and other intellectual property.
- Liquidate securities on timely basis and do not play the market

B. The Auction

- List assets for sale on web site for public notice
- Employ auctioneer for asset sale with online bidding
- Email all creditors with auction details and preview as they may have information on assets
- Review auction contract and any contract with estate sales company to ensure they are properly collecting sales tax.
- If competitive bidding for real property is anticipated, consider having current title search, survey and current appraisal prepared
- Personally inspect assets prior to the auction to verify and make certain what property is being sold
- After auction, arrange for junk dealer to remove and sell remaining assets
- Consider contacting the media when the auction is planned to provide update on the story and get free press for the auction.

C. Preparing for Litigation

- Business Records
 - Resist the temptation to abandon unnecessary and burdensome business records
 - Beware of possible discovery issues and future need of records in litigation
 - Don't destroy records until the case concludes
 - Make sure that ESI is properly imaged and preserved at beginning of case. Don't underestimate the importance of ESI and the need for access when litigation commences.
- Net Winner Fraudulent Transfer Actions
 - Review possible recovery of false profits known as claw-back claims.
 - Prepare a cost benefit analysis to determine which actions should be pursued.

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- Determine threshold recovery amounts to preserve assets of the estate.
 - Evaluate likely collectability against possible targets.
- Principals, Related Parties, and Affiliates
 - Investigate transactions with principals and related parties and determine if any causes of action exist.
 - Review documents regarding other entities controlled by Debtor and related parties and determine whether there are other subsidiaries that should be considered for substantive consolidation
- Banks
 - Draft letter to all banks, investment houses, brokerages, etc. where Debtor had accounts to ensure that all accounts have been frozen and/or closed.
 - Investigate relationships and transactions with bank for consideration of potential liability
 - Subpoena all bank account records and begin tracking all documents produced
- Charitable Organizations
 - Evaluate recovery of charitable contributions or gifts
 - Consider collectability, costs and optics
- Brokers and Sales Agents
 - Consider recovery of commissions paid to brokers
 - Compare amounts paid to market rates
 - Consider collectability
 - Identify investors that given broker solicited
- Insurance
 - Obtain copies of all insurance policies
 - Review all applicable insurance policies to evaluate possible insurance coverage
 - Take note of exceptions when preparing litigation claims

VIII. Organizing the Litigation Investigation

A. Assembling a Team

- Lawyers
 - General counsel v. litigation counsel
 - Flexible fee arrangements
- Forensic accountants
 - Investigative work
 - Litigation support experience
 - Expert witness experience
- Financial Advisors

- Auditors
- Investigators

B. Gathering Information

- Interviews
 - Principals
 - Employees
 - Investors
 - Auditor/Accountant
- Existing Records
 - Files on site
 - Storage facilities
 - Electronically stored information
 - Online access to bank records
 - Web-based stored records
 - Social media
- Third Party Records
 - Financial Institutions
 - Records from foreign financial institutions
 - Escrow companies
 - Investors
- Prior Professionals
 - Counsel
 - Accountants
 - Brokers
- Drafting subpoenas

C. Preliminary Issues for Counsel

- Administrative Issues
 - Employ counsel
 - Establish budget and staffing
- Employee Issues
 - Ensure litigation holds are in place
 - Preserve testimony and records
- Evaluate pending litigation
 - Stay litigation against Debtor
 - Evaluate litigation in which Debtor is a plaintiff
- Evaluate available insurance before making allegations in reports, disclosure statements or litigation; coordinate with litigation counsel
 - Directors and Officers

- Malpractice
 - Liability
- Attorney-client privilege issues
 - On company computers
 - In information obtained from prior counsel
- Personally identifiable information
- Evaluate costs of litigation

D. Discovery and Evidence

- Know your forum
 - Federal court
 - State court
 - Arbitration
- Map out a discovery plan
- Electronically stored information
 - Where to find it
 - How to preserve it
 - The scope of discovery requests
- Social Media
 - Business v. personal sites
- Where to look for hidden assets
 - Public searches
 - Bank records
 - Real estate records
 - Tax returns
 - Credit card statements
- Chain of custody issues
- Privacy and Protective Orders
- Depositions
 - Percipient witnesses
 - Expert witnesses

IX. Fraudulent Transfer Claims

A. Identify the transfers

B. Create a database

- Identify relevant accounts
- Obtain data from bank, credit and investment statements
- Create appropriate fields for the database
- Create an index

- C. Analyze the data
 - Tracing funds
 - Dealing with commingled funds
 - Sort to identify transferees
 - Locate relevant related documentation
 - Identify subsequent transferees
- D. Elements of the Claim
 - Actual fraudulent transfer claims
 - Constructive fraudulent transfer claims
 - Ponzi scheme presumption
 - Good faith defense
- E. Targets of fraudulent transfer claims
 - Net winners
 - Brokers commissions
 - Insiders
 - Friends and family
- X. Other Litigation Issues
 - A. Standing
 - Claim belonging to estate
 - Individual claims
 - B. *In Pari Delicto*
 - C. Related Class Actions
 - D. Types of third-party litigation claims
 - Breach of Fiduciary Duty
 - Negligence
 - Negligent Misrepresentation/ Negligent Supervision
 - Malpractice and Professional Negligence
 - Fraud/Fraudulent Misrepresentation or Concealment
 - Aiding and Abetting Fraud
 - Aiding and Abetting Breach of Fiduciary Duty
 - Conspiracy
 - Conversion
 - Securities law violations
 - Deepening insolvency

XI. Expert Reports

- A. Assess the needs of the case
- B. Locate a qualified expert
 - Vetting the witness
 - References
 - Personal interview
- C. The engagement letter
 - Compensation
 - Confidentiality
- D. Define the scope of opinions needed for the expert report
- E. Assistance of counsel in preparing the expert report

XII. Issues in Operating Case

- A. Review cash flow
- B. Accounts receivable
- C. Inventory
- D. Employee files
- E. Credit card usage
- F. Types of fraud in operating business
 - Cash larceny
 - Embezzlement from accounts receivable
 - Billing fraud
 - Fraudulent expense reports
 - Financial statement fraud

XIII. Mediation and Settlement

- A. Confidentiality concerns
- B. Drafting settlement agreements