



, Posted On: 10/28/2009

## Experts see trend in court rulings that favor receivers' "clawback" efforts

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- > *Trend toward more uniform treatment of receivers*

Rob Garver

As receivers and trustees around the U.S. continue to unravel the numerous Ponzi schemes and other financial frauds that have been revealed over the past year, the tactic of using "clawbacks" under the Uniform Fraudulent Transfer Act to bring back into the receivership estate assets that were paid out as either profits or payments to complicit parties is increasingly in play.

The good news for receivers and trustees looking to recover assets for wronged investors is that a growing body of case law has been working to dismantle some of the most effective defenses against lawsuits seeking to take back Ponzi scheme profits through UFTA suits. It is a welcome development in a field of law where the treatment of receivers has not always been consistent.

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"There are some issues in the clawback realm that are fixed across the country," said Los Angeles attorney Kathy Bazoian Phelps, with Danning, Gill, Diamond & Kollitz, "but others vary widely from circuit to circuit."

Historically, a key defense against a clawback effort has been for the defendant to challenge the standing of the receiver to bring the suit at all. These challenges often take two forms. A defense commonly used by individuals who may be complicit in the fraud, such as an outside accountant or legal advisor, is for the defendant to claim that, because the receiver has stepped into the shoes of the wrongdoer, that he has "unclean hands" and therefore cannot bring suit. Another tactic is to

claim that, as a representative of the receivership state, he does not have the standing to bring suit on behalf of wronged investors.

The first, known as the *in pari delicto* ("in equal fault") defense, created a situation in which wrongdoers who accepted payment from a fraudster might escape clawbacks entirely because investors themselves have no cause of action against an individual who provided services to the company involved in the fraud. If the receiver were equally without standing, then there would be no chance of recovering that money.

But that defense is losing its power to shelter those who have abetted fraud.

"There appears to be an emerging trend where courts are allowing the receiver or non-bankruptcy trustee to avoid the *in pari delicto* defense in claims against tortfeasors," writes Phillip S. Stenger in his [Receivership Sourcebook](#).

## **The 7th Circuit ruled that a company in receivership had been effectively removed from an "evil zombie state."**

The influential 7th Circuit Court of Appeals in 2007 ruled in *Scholes v. Lehman*, that a company in receivership had been effectively removed from an "evil zombie state" in which it existed under the

management of a fraudster, and that the *in pari delicto* defense should not apply.

That reasoning was adopted by the 9th Circuit Court of Appeals in *Donell v. Kowell*, a case that, earlier this year, the United States Supreme Court declined to hear on appeal.

Stenger, who has called *Donell* "a very good case for receivers," sees the ruling and the Supreme Court's unwillingness to hear the appeal as a sign of movement, however slow, toward more uniform treatment of receivers.

"The Scholes case now has some good company in another circuit," said Stenger, an attorney with Stenger & Stenger in Grand Rapids, Mich. The two rulings, he said in an interview, though not precedent-setting outside their own districts, are likely to affect the thinking of other Circuit Courts across the country where the issue of a

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receiver's standing in fraud cases is not settled law.

The *Donnell v. Kowell* ruling also had an additional benefit, according to Phelps, by addressing another of the arguments used to defend against clawbacks made under the UFTA — an investor's good faith.

"It made explicit things that had not been previously made explicit in the context of a receiver," she said. "It made unequivocal that the receiver has the standing to file suit seeking clawbacks of profits paid out to investors."

In an article about the case, she noted, "Investors' good faith may be relevant as a defense regarding a return of principal, but will not protect them from claims to recover profits."