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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Reading The Playbook Of Fraud's Aftermath

Law360, New York (October 03, 2011, 2:07 PM ET) -- Unfortunately, reading about yet another Ponzi scheme scandal these days is like reading about the final space shuttle launch. Both are remarkable events that now, because of the frequency with which they occur, have been moved well below the day's headlines. As we are past the awe and wonder of sending a 2,000-ton vehicle to space and having it return like a glider at the local airport, it seems as though we have similarly accepted unscrupulous investment managers as being commonplace, especially in the current economic landscape. As Warren Buffet says, "It's only when the tide goes out that you learn who's been swimming naked." Well the beach is now littered with naked bodies, and nobody seems to be alarmed anymore.

However, every now and then, the subplot surfaces and a newsworthy event makes it back to the front page. One such subplot is the August discovery that notorious South Florida $900 million Ponzi schemer and big-time University of Miami athletic booster Nevin Shapiro showered Miami Hurricanes athletes with lavish gifts, including money, vehicles and prostitutes.

Those that follow NCAA sports at all, and those that got into the movie "The Blind Side," are not exactly shocked by this revelation. I could go on for days dissecting the long history of the sexy, yet destructive and unscrupulous inner workings of Division I athletic programs and how we have completely turned our cheek to the obvious improprieties that abound in college sports. Yet if you are a die-hard Hurricanes fan, or, worse yet, if you were the recipient of the aforementioned luxuries, then there's plenty to get worked up about.

These fans and recipients of Shapiro's "generosity" are now part of fraud's aftermath. Like Bernard Madoff, Tom Petters, Allen Sanford and Charles Ponzi himself (who, interestingly enough, around 1920 was not the first Ponzi schemer — only the most famous), every schemer leaves a mess that requires cleaning up. Some of us cleanup men are now becoming as famous as the fraudsters themselves.

Take Irving Picard of Baker & Hostetler LLP, for instance, the Securities Investor Protection Act and bankruptcy trustee for the Madoff enterprise. Picard makes the business headlines time and time again as a result of his efforts to recoup the $60 billion in losses occasioned by the Madoff scheme. He's sued everyone, from allegedly unscrupulous feeder funds to major banks and even owners of professional baseball teams.

And then there's Douglas A. Kelley of Kelley Wolter & Scott PA, the receiver and trustee of the Petters enterprise. Like Picard, he's a frequent panel member at conferences worldwide and is even the subject (many would say a target) of a full-length documentary produced by one of the estate's largest (and loudest) creditors. He, too, has been involved in a variety of litigation attempting to recover assets from the Petters debacle, often suing various unsuspecting targets.

Like Madoff, Petters and the rest, as Shapiro sits behind bars, he gets his own cleanup man, in this case, Miami attorney Joel Tabas of Tabas Freedman Soloff Miller & Brown PA. Tabas is now charged with wading through potentially hundreds of thousands of pages of documents and emails, conducting interviews and dissecting bank statements and cash flows to find out where the money went.

Then, he's charged with recovering it. Though this is relatively simple in theory, the reality is that Ponzi schemers like Shapiro often have convoluted bank records, overly complex money movement, an unnecessarily high volume of corporate entities and very few assets in their own names. What's more, many times the money is so long gone that recovery is wildly expensive, meaning that the payout to victims can be drastically reduced by the administrative costs resulting from the recovery effort.

And then there's the determination of who is, in fact, a victim. Substantial litigation is pending, especially in Madoff, which may rewrite the books on classifying victims. For instance, are you a victim if you received more than you invested, or are you only a victim it you received less? By the very nature of a Ponzi scheme, someone received something in the way of a return on investment along the way to develop inflated, albeit false returns, that enticed additional investors and dollars. So are the early "investors" victims, or only those who last invested before the scheme crumbled or the Feds swooped in.

The answer is not yet clear, though this creates yet another major hurdle for the cleanup folks, especially, as in Madoff and Petters, where there are contentious and again expensive battles occurring at the hands of angry investors who now claim to be victims despite having gotten early returns.

So what does all of this have to do with the Miami Hurricanes? Two words: fraudulent transfers. The axiom of the Uniform Fraudulent Transfer Act and related provisions of the U.S. Bankruptcy Code is thus: If you gave it away for less consideration than what it was worth, then you have to give it back. Sure, there's a bit more to it than that, such as a showing of insolvency, etc., though in general, Tabas, in his quest to recover every last possible dollar from every last possible source, is now poised to force many current and past University of Miami football and basketball stars, several now playing in professional leagues, to give back what they received for less than reasonably equivalent value (i.e., for free).

Assuming Tabas meets a baseline set of financial criteria relative to the time of the transfer, he's likely to succeed. These gifts, if they were, in fact, given as claimed, constitute a transfer of Shapiro's assets for no consideration and can be "clawed back" by the trustee. What's more, if the asset no longer exists, then Tabas can get a judgment for the value of the asset at the time of the transfer.

So if that Escalade that a former Miami football player received is sitting rusted with a dropped transmission, that's too bad. It was worth $50,000 then and $50,000 is what Tabas is entitled to recover now. Though seemingly cheap against the whole, this is "low hanging fruit" for the trustee and will likely result in a number of quick settlements as many of the targets will not want the negative exposure that will result from such a high-profile matter, in turn generating sorely needed cash with which to run the estate and hopefully pay to creditors.

There is also another, even more compelling aspect of fraud's aftermath: understanding the fraudster. If we continually focus on recovery, then we are treating the symptom and not the cause, and treating the cause is necessary for the most effective recovery. The best of the cleanup folks, the ones who both quickly ferret out the fraud and amass the largest recoveries, are the ones who have had a glimpse into the personality of a model fraudster, unfolding the story behind each scheme and appreciating the intelligence, no matter how misguided, that developed the scheme in the first place. To recover from fraud, you need to know fraud.

Nevin Shapiro, for instance, is a model fraudster, the guy you love to be with, personable, charming and a ball at parties. True, he was more smitten with the spotlight than most, yet his behavior helped to create a desire to be associated with him. Combine this with his callous disregard for the result and lack of accountability, including the potential destruction of one of the nation's most storied college football programs, and you quickly understand how easy it was for him to do what he did.

Even from his prison cell, he is quick to hold others accountable for what happened at the University of Miami, willing to now implicate the entire program as a means not of escaping liability but of rationalizing what he did. A fraudster's "kill-or-be-killed," primordial instincts lead him (yes, they are nearly all male) to do whatever it takes to conquer, to show superior intellect and power, all without regard to who may be a victim along the way.

And speaking of victims, it's important also to note that fraud can't exist without them. However, the victims should not be completely free from accountability, for in Ponzi scheme cases, we see all too often another compelling personality trait: greed. It's easy to see that greed is the most prevalent of all behavioral characteristics when people are driven to defy a cardinal rule of investing, which teaches that one should never put all of their eggs in one basket (as in Madoff). And for the University of Miami (and many other NCAA schools), greed, sometimes combined with an impoverished upbringing in which such luxuries were not accessible, drives players and the program to freely accept these gifts and place Shapiro on a pedestal, despite the possible consequences.

So while we publicly persecute Shapiro and his formerly unfathomable conduct, we must also understand that he could not have done what he did if it were not for those who wanted to get rich quick or bask in the forbidden luxuries of a college booster. The takeaway from this and most other Ponzi and fraud schemes is thus: "Willful disregard" or "indifference to the truth" becomes the wound that the fraudster smells when choosing his prey.

In the playbook of fraud's aftermath are many plays that lead a trustee toward the end zone of recovery. These plays involve both established and cutting-edge legal theories, as well as the need to have a keen understanding of the fraudster and the alleged victims. Studying these game films is a necessary task for any cleanup person charged with mopping up the fraudster's domain.

--By Neal H. Levin, Freeborn & Peters LLP

Neal Levin is a partner in the Chicago office of Freeborn & Peters, where he heads the firm's fraud team. He represents clients relative to the prosecution, investigation and recovery of assets that result from the many varieties of fraudulent activity, corruption and other misconduct, providing an end-to-end solution, from fraud investigation through post-judgment asset recovery.