UNLOCKING A RECEIVER'S ARSENAL: A RECEIVER'S BEST "WEAPONS"

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BIOGRAPHICAL INFORMATION

KELLY CRAWFORD

Kelly Crawford is one of the founding partners of Scheef & Stone, LLP, a full service business law firm started in March, 1998. Mr. Crawford graduated from SMU law school, *cum laude*, in 1986, where he was a Hatton Sumner Scholar and served as Editor in Chief of the JOURNAL OF AIR LAW & COMMERCE. He is currently on the board of directors of the National Association of Federal Equity Receivers, and has been recognized as a Texas Super Lawyer for the past three years. He is also a Life Fellow of the Texas Bar Foundation. Mr. Crawford served as a panelist in 2002 and 2010 on the topic of receiverships at the Annual Southwest Securities Enforcement Conference sponsored by the Fort Worth Office of the Securities and Exchange Commission. During the past 12 years, Mr. Crawford served as the Receiver in eight receiverships brought by the Securities and Exchange Commission, five receiverships brought by the U.S. Commodity Futures Trading Commission, three receiverships brought by secured lenders; and one receivership brought by the State of Texas. He has been appointed Receiver by federal court judges in the Northern District of Texas (Judges Boyle, Godbey, Lindsay, Lynn, O'Connor, and Solis); the Western District of Texas (Judge Sparks); the Eastern District of Texas (Judges Davis and Schneider); and the Southern District of Texas (Judges Ellison, Lake, and Rosenthal). Mr. Crawford successfully argued *Warfield v. Byron,* 436 F.3d 551 (5th Cir. 2006) before the Fifth Circuit, which affirmed the right of a receiver to recover broker's commissions.

CHARLENE KOONCE

Charlene C. Koonce is a partner at Scheef & Stone, LLP, where she has practiced commercial litigation since 1998. Ms. Koonce graduated *magna cum laude,* from Abilene Christian University, and in 1991, graduated *cum laude,* from Pepperdine School of Law. During law school, Ms. Koonce served on the Pepperdine Law Review and spent one semester as a full-time intern for Judge Sidney Fitzwater. While Ms. Koonce's litigation practice has included commercial disputes arising from virtually every conceivable subject matter, since at least 1999 the majority of her practice has focused on receivership work. Ms. Koonce has served as an equity receiver and a distribution agent in SEC enforcement cases, and has represented equity receivers in more than a dozen SEC and CFTC enforcement cases, in addition to representing receivers in multiple ancillary lawsuits which arise in most receiverships. Ms. Koonce has represented receivers in each of the four federal districts in Texas, as well as in the Fifth Circuit, including successfully arguing *Crawford v. Silette,* 608 F.3d 275 (5th Cir. 2010), and briefing more than 15 appeals in which favorable rulings were obtained without oral argument.

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I. INTRODUCTION

For many, the extent of a receiver's power is a mystery. Although receiverships are somewhat similar to bankruptcies, receiverships are grounded in the ambiguities of equity while bankruptcies are governed by specific statutes. For instance, a bankruptcy trustee's powers are controlled by the Bankruptcy Code and whenever a question arises as to whether a trustee can or cannot do something, attorneys and courts turn to the specific bankruptcy statute that provides the source of the trustee's power. In equitable receiverships, however, no federal statute defines a receiver's power. Instead, the appointing court's discretion to craft necessary and appropriate equitable relief creates and defines a receiver's authority. What does that mean? What are the parameters of a receiver's power? This article answers these questions by examining a receiver's ten most effective weapons.

II. POWERS OF A RECEIVER

A. What is the Source of a Receiver's Powers?

The court order appointing the receiver (the "Receivership Order") defines a receiver's powers. The Receivership Order determines which assets are in receivership and subject to the receiver's control; includes express provisions empowering the receiver to take all manner of steps to secure, preserve, and liquidate property; and includes instructions to defendants and those acting in concert with the defendant regarding the required response to the receiver's demands. Once assets are placed in receivership by issuance of a Receivership Order, a receiver's powers are enhanced by a federal statute that expands the receiver's and appointing court's jurisdiction over the assets. As a result, a receiver's powers exist only if granted by the appointing court, implied from the Receivership Order, or provided by a specific statute.

Appointment of a receiver is an equitable remedy, and thus, the parameters of the Receivership Order and administration of a receivership are subject to a district court's discretion. Although very little case law discusses the administration of equity receiverships and most cases are fact specific, two basic principles are recognized as governing most receivership proceedings. First, district courts are given "extremely broad" discretion in determining "the appropriate procedures to be used in the administration of receiverships." *FDIC v. Bernstein,* 786 F.Supp. 170, 177 (E.D.N.Y. 1992); *SEC v. Safety Fin. Service, Inc.*, 674 F.2d 368, 372 (5th Cir. 1982)("Any action by a trial court [judge] supervising an equity receivership is committed to his sound discretion and will not be disturbed unless there is a clear showing of abuse"); *SEC v. Hardy*, 803 F.2d 1034, 1037 (9th Cir. 1986). Second, "a primary purpose of equity receiverships is to promote orderly and efficient administration of the estate by the district court for the benefit of creditors." *Hardy,* 803 F.2d at 1038. Accordingly, "reasonable procedures instituted by the district court that serve [these] purpose[s]" are generally upheld. *Id.* Therefore, although competing creditors and investors may disagree about whether a receiver's authority and actions are fair and equitable, when a question arises as to whether a provision of the Receivership Order is valid, or whether a receiver is properly acting within the confines of the Receivership Order, the appointing court (the "Receivership Court") uses equity and "fairness" to provide the answer.

B. Who Controls a Receiver?

A receiver is an agent of the appointing court, and answerable to the court. *Clark v. Clark*, 58 U.S. 315, 331, 15 L.Ed. 77 (1855)(A receiver is neither plaintiff nor defendant, but instead, acts as the court's agent with respect to the administration of property); *FSLIC v. PSL Realty Co.*, 630 F.2d 515, 521 (7th Cir. 1980), *cert. denied,* 452 U.S. 961, 69 L.Ed.2d 971, 101 S.Ct. 319 (1981)(A "receiver is an officer of the court and subject to its orders in relation to the property for which he is responsible until discharged by the court"); *Federal Home Loan Mortgage Corp. v. Spark Tarrytown, Inc.*, 829 F.Supp. 82, 85 (S.D.N.Y. 1993). Thus, receivers do not work for the governmental agency or secured creditor that sought his or her appointment. *SEC v. Elfindepan, S.A.*, 169 F.Supp.2d 420, 424 (M.D.N.C. 2001)("Receiver is not the exclusive agent or representative of either party to the suit in which she is appointed, and she is not appointed for the benefit of either party, nor does she derive her authority from either one.")

C. General Powers of a Receiver

In most federal equity receiverships, a receiver is directed to assume possession and control over the defendants' (individuals or entities) assets and take control of the defendants' business operations, if any, so all available assets may be recovered and used to pay the victims of the defendants' wrongful conduct which gave rise to the action.[1] As a result, a

[1] For instance, the typical Receivership Order includes the following language: "This court assumes exclusive jurisdiction and takes possession of the assets, monies, securities, properties, real and personal, tangible, of whatever kind and description, wherever located, and the legally recognized privileges (with regard to the entities) of the Defendants and all entities they own or control

Receivership Order generally grants significant powers to a receiver to allow him to wrestle control away from the defendants and act in the interest of investors and creditors. In exercising these powers, the Receivership Order is a receiver's source code, and equity is the receiver's compass.

D. Specific Powers of a Receiver

This article addresses ten of the most significant weapons available to a federal[2] equity receiver. Each of the weapons is derived from provisions commonly found in federal Receivership Orders, have been endorsed by the federal courts, and are based on the broad principles of equity that underlie the reasons for the receiver's appointment.

1. Power To Recover Assets And Assert Claims Nationwide

Receivership Orders generally vest a receiver with possession and control over all "Receivership Assets" "wherever located" and direct the receiver to "collect, marshal, and take custody, control, and possession of such assets." Although this task is often easier said than done, it is greatly facilitated by a receiver's ability to obtain nationwide jurisdiction over assets and persons.

One of the receiver's first tasks upon appointment is to identify the potential location of all assets or persons with claims to such assets. If the receiver files a copy of the Receivership Order and the underlying Complaint in each federal district where such assets or persons are located within ten days of the issuance of the Receivership Order, the appointing court acquires *in rem* jurisdiction over all property located in these other judicial districts, personal jurisdiction over any person in possession or control of such assets, and subject matter jurisdiction over any claim or case related to such assets. 28 U.S.C. § 754[3]; *Crawford v. Silette,* 608 F.3d 275, 277-78 (5th Cir. 2010)(Finding subject matter jurisdiction in the District Court for the Eastern District of Texas over a Florida condominium and a Florida resident, where the receiver complied with 28 U.S.C. § 754); *SEC v. Bilzerian*, 378 F.3d 1100, 1103 (D.C. Cir. 2004), *cert. denied, sub nom., Haire Meshulam,* 544 U.S. 1017, 125 S.Ct. 1972, 161 L.Ed.2d 856 (2005).

Additionally, compliance with § 754, together with the provisions of 28 U.S.C. § 1692[4], provide the statutory support for nationwide service of process, and nationwide personal jurisdiction. *Haile v. Henderson National Bank*, 657 F.2d 816 (6th Cir. 1981)(Appointing court may exercise "nationwide personal jurisdiction based on presence of the defendant in the United States, rather than in any particular state" where receiver has complied with 28 USC § 754, and serves a defendant anywhere within the territory of the United States); *Bilzerian*, 378 F.3d at 1103, (finding court had personal jurisdiction over non-resident pursuant to 28 U.S.C. §§ 754 and 1692, and Rule 4(k)(1)(D)); *Quilling v. Stark*, 2006 WL 1683442 at *3 (N.D. Tex. Jun.19, 2006)("Together, these statutes [28 U.S.C. §§ 754 and 1692] give a receivership court both *in rem* and *in personam* jurisdiction in all districts where property of the receivership estate may be located.") "[T]o invoke §

("Receivership Assets"), and the books and records, client lists, account statements, financial and accounting documents, computers, computer hard drives, computer disks, internet exchange servers, telephones, personal digital devices and other informational resources of or in possession of Defendants, or issued by Defendants and in possession of any agent or employee of Defendants ("Receivership Records"). ____ is appointed temporary Receiver for the Receivership Assets and Receivership Records (collectively, "Receivership Estate") with the full powers of an equity receiver under common law as well as such powers as are enumerated herein as of the date of this order …"

[2] This article addresses federal equity receiverships. Vastly different rules and statutes apply to receivers appointed in state court proceedings, and this paper is not intended to address the specific authority of state court receivers. For instance, the most significant distinctions between state and federal court receiverships are: 1) state receiverships are necessarily limited to assets within the state's jurisdiction; and 2) assets exempt under state law are generally not included within the assets in receivership.

[3] 28 U.S.C. § 754 provides:

> A receiver appointed in any civil action or proceeding involving property, real, personal or mixed, situated in different districts shall, upon giving bond as required by the court, be vested with complete jurisdiction and control of all such property with the right to take possession thereof.
> ***
> Such receiver shall, within ten days after the entry of his order of appointment, file copies of the complaint and such order of appointment in the district court for each district in which property is located. The failure to file such copies in any district shall divest the receiver of jurisdiction and control over all such property in that district.

[4] 28 U.S.C. § 1692 provides:

> In proceedings in a district court where a receiver is appointed for property, real, personal, or mixed, situated in different districts, process may issue and be executed in any such district as if the property lay wholly within one district, but orders affecting the property shall be entered of record in each of such districts.

1692, [however] a receiver first must comply with 28 U.S.C. § 754." *SEC v. Vision Comm'n, Inc*., 74 F.3d 287, 290 (D.C. Cir. 1996); *Warfield v. Arpe*, No. 3:05-cv-1457-R, 2007 WL 549467, at *11 (N.D. Tex. Feb. 22, 2007)("By not complying with § 754, a receiver fails to establish control over receivership property and cannot effect valid service of process under § 1692, which precludes using Rule 4(k)(1)(D) as a basis for personal jurisdiction."). Thus, these two statues allow a receiver to file a claim or an ancillary lawsuit in the Receivership Court against any person or entity located anywhere in the United States, regardless of personal jurisdiction or the location of the subject assets. *Crawford,* 608 F.3d at 278 ("It is an undisputed proposition that the initial suit which results in the appointment of the receiver is the primary action and that any suit which the receiver thereafter brings in the appointment court in order to execute his duties is ancillary to the main suit. As such, the district court has ancillary subject matter jurisdiction of every such suit irrespective of diversity, amount in controversy, or any other factor which would normally determine jurisdiction"), *quoting, Haile,* 657 F.2d at 822.

Moreover, when national service of process is permitted, establishing personal jurisdiction requires only minimum contacts with the United States rather than the forum state. *Busch v. Buchman, Buchman & O'Brien, Law Firm, et al.*, 11 F.3d 1255, 1258 (5th Cir. 1994); *Vision Comm'n, Inc.*, 74 F.3d at 387; *Haile*, 657 F.2d at 825-26; *SEC v. Equity Serv. Corp.*, 632 F.2d 1092, 1095 (3d Cir. 1980); *United States v. Franklin Nat'l Bank*, 512 F.2d 245, 249 (2d Cir. 1975).

Sometimes, after the initial ten days of the receivership, a receiver discovers assets in jurisdictions in which the receiver did not file the Receivership Order and Complaint. To establish jurisdiction over the newly discovered assets, a receiver may request issuance of an "Order of Reappointment"[5] and then file the Reappointment Order and Complaint in the districts where the newly discovered assets are located. In essence, a district court may reset 28 U.S.C. § 754's ten day clock by reappointing a receiver. *Vision Comm'n, Inc.,* 74 F.3d at 291; *Terry v. Walker*, 369 F.Supp.2d 818, 820-21 (W.D. Va. 2005); *SEC v. Equity Serv. Corp*., 632 F.2d 1092, 1095 (3d Cir. 1980)(Holding "a receiver who has failed to file within the ten-day period [can] reassume jurisdiction by a later filing, as long as the rights of others have not been prejudiced during the intervening period"); *Warfield,* 2007 WL 549467 at *12.

The ability to compel any person located anywhere in the United States to appear in the Receivership Court and defend against a receiver's claims, regardless of his or her contacts with the forum state, provides a powerful tool. Many such persons decide to comply with the Receivership Order and cooperate with the Receiver purely to avoid the expense and difficulties of litigating in the distant Receivership Court.

2. Power To Recover Assets Outside The United States

Recovering assets held outside the United States is one of the most difficult challenges for a receiver. Since the receiver's source of power arises from a Receivership Order issued by a United States district court, most persons or entities in foreign countries will refuse to obey or simply ignore the Receivership Order. Preliminarily, a receiver should consult with the governmental agency that filed the action giving rise to the receivership to determine if the agency itself can assist, or if the agency can enlist the assistance of the United States Department of Justice. For instance, the Securities and Exchange Commission's Office of International Affairs is very effective in assisting receivers with the recovery of assets in foreign jurisdictions. Likewise, some countries are parties to treaties with the United States regarding the mutual enforcement of freeze orders and exchange of financial information, and will only cooperate with the Department of Justice, as opposed to receivers, in complying with those treaties.

Some countries, however, refuse to cooperate with the United States. Nonetheless, several options exist for a receiver to obtain possession of assets located off-shore. First, if a receiver can obtain evidence indicating the defendant in receivership owns or controls the extra-territorial assets, the receiver can request the Receivership Court to hold the defendant in contempt of court for failing to turn those assets over to the receiver. The defendant can, of course, execute directives instructing the holder of the assets outside the United States to turn over the assets to the receiver. Often times, the foreign institution holding the assets will comply with the instruction letter after verifying its authenticity.

Difficulties arise if the defendant cannot be found, or in some cases, if the defendant is already incarcerated. Threatened incarceration for contempt of court is obviously a moot threat for a defendant already incarcerated. Nevertheless, a defendant can sometimes be persuaded to cooperate if he understands that incarceration for civil contempt is distinct from incarceration for a criminal act, and that at sentencing for the criminal act, the defendant usually will not receive credit for time served for civil contempt. Indeed, even the fulfillment of a criminal sentence will not satisfy a civil contempt. *In re Grand Jury Proceedings,* 880 F.2d 416, *2 (9th Cir. 1989)(unpublished)(Finding no error and no violation

[5] The order of reappointment is identical to the original Receivership Order, except for the date of issuance.

of the Federal Sentencing Guidelines in requiring criminal defendant to be incarcerated for civil contempt consecutively to fulfillment of defendant's criminal sentence); *In re Grand Jury Investigation,* 865 F.2d 578, 582 (3d Cir. 1989)(Finding that federal courts may interrupt prior criminal sentences to impose civil contempt incarceration, and the civil contempt time provides no credit for the criminal sentence). Therefore, the possibility of a defendant remaining incarcerated if he has not purged himself of civil contempt, even after completing a criminal sentence, may provide sufficient inducement to obtain the defendant's cooperation in repatriating assets.[6]

Alternatively, a receiver can seek an order from courts in the foreign jurisdiction compelling the holder of the assets to turn over the assets to the receiver. This alternative is usually expensive since it requires hiring foreign law firms to serve as local counsel and navigate their way through the foreign jurisdiction to obtain the appropriate order. In addition, countries vary in how they will respond to a United States receiver seeking to exercise authority in their courts. Sometimes, even if a foreign court recognizes a Receivership Order and thus agrees to enforce a receiver's authority to act, the foreign court will still require independent proof that a fraud has been committed in their country or that an extraordinary remedy such as a freeze order or turnover order should be issued.

Finally, if the holder of assets in a foreign country refuses to recognize the Receivership Order, and if an action in the foreign country is not feasible, a receiver may seek enforcement of the Receivership Order through alternative processes in the United States. As an example, a receiver used the following strategy to successfully recover $500,000 held by the Bank of Nevis in Anguilla. The Receiver obtained evidence that defendants in the receivership were operating their Ponzi scheme through the Bank of Nevis in the Caribbean. The Receiver retained local counsel in Anguilla, appeared before the Eastern Caribbean Supreme Court, and obtained an order freezing funds in the Bank of Nevis and compelling the Bank of Nevis to turn over bank records. The Bank of Nevis complied with the order issued by its local court, and turned over bank records to the Receiver showing the Bank of Nevis still held $510,759 of investor funds. Shortly after the Receiver left Anguilla, however, persons assisting the defendants appeared before a different judge of the Eastern Caribbean Supreme Court and obtained an order dissolving the freeze order.

Concurrently, the Receiver discovered the Bank of Nevis had its own correspondent account at ABN-AMRO and held significant assets at that United States bank. To obtain the Bank of Nevis' "cooperation" in turning over the receivership assets located in Nevis and thus beyond the jurisdictional reach of the Receivership Order, the Receiver obtained an order from the Receivership Court freezing the Bank of Nevis' monies at ABN-AMBRO up to the total of investor funds traced to the Bank of Nevis. After notice and a hearing, the Receivership Court ordered ABN-AMRO to deposit the frozen funds into the registry of the Receivership Court. The Bank of Nevis never contested the freeze order nor made claim to the monies deposited into the registry of the Court. As a result, the monies were turned over to the Receiver and distributed to the defrauded investors.

Thus, assets located off-shore are not immune to a receiver's powers and foreign persons and entities who initially refuse to voluntarily comply with a Receivership Order ultimately may be forced to obey the order.

3. Power Of Contempt

Undoubtedly, the threat of civil contempt as a coercive sanction provides the single most effective weapon in a receiver's battle to obtain possession and control of Receivership Assets. Unlike most litigants who begin discovery premised solely on a scheduling order and the Federal Rules of Civil Procedure, a receiver is armed with the injunctive provisions of the Receivership Order which generally require defendants as well as "all persons who receive notice of the order" to turn over books, records, and assets to the receiver, and to otherwise cooperate with the receiver in his investigation of Receivership Assets. Failure to comply with the Receivership Order results not in a discovery order, but in a finding of contempt, punishable by coercive imprisonment or multiplying fines. The procedure for a receiver to compel compliance with a Receivership Order through the threat of contempt is straightforward.

Upon appointment, the receiver immediately provides a copy of the Receivership Order to all known persons and entities (such as banks, brokers, or non-parties) believed to have possession of Receivership Assets – assets owned or controlled by the receivership entities. In a cover letter, the receiver quotes the provisions of the Receivership Order requiring the recipient (the "target") to turn over such assets to the

[6] In *SEC v. Benjamin Franklin Cook;* Civil Action No. 99-CV-0571, United States District Court Judge Jerry Buchmeyer held the Defendant Benjamin Franklin Cook in contempt of court for failing to comply with a receivership order and when Defendant Cook was extradited to Arizona for sentencing by the State of Arizona for running an illegal Ponzi scheme, Judge Buchmeyer specifically ordered that Cook was to be returned to Texas and to Judge Buchmeyer's court until Cook purged himself of contempt of Judge Buchmeyer's order.

receiver. The receiver emphasizes that compliance with the turnover demand is mandated by a federal court order and provides the target with express instructions regarding when and how the asset is to be turned over to the receiver. If the target fails to comply, even after receiving a "grace note" warning of the impending contempt, the receiver files a Motion for Show Cause hearing in the Receivership Court.

The Motion for Show Cause need only demonstrate by clear and convincing evidence the existence of a valid court order– the Receivership Order – which required certain conduct by the respondent, the respondent's knowledge of the Order, and his or her failure to comply. *Whitcraft v. Brown,* 570 F.3d 268, 271 (5th Cir. 2009); *SEC v. First Fin. Group of Texas, Inc.,* 659 F2d 660, 669 (5th Cir. 1981)(A party commits contempt when, with knowledge of a court's definite and specific order, he fails to perform or refrain from performing what is required of him in the order). Most courts will immediately set a hearing to consider the contempt. Notice of the hearing should be personally served[7] on the target.

At the hearing,[8] once the receiver meets the burden outlined above, the alleged contemnor must demonstrate through *credible* evidence that he either complied with the Receivership Order, or has a current inability to comply. *Quilling v. Funding Resource Group*, 227 F.3d 231, 235 (5th Cir. 2000)("[C]ontemnor must prove his inability to comply with a court order with credible evidence"); *CFTC v. Wellington Precious Metals, Inc.*, 950 F.2d 1525, 1529 (11th Cir.), *cert. denied*, 506 U.S. 819, 113 S.Ct. 66, 121 L.Ed.2d 33 (1992)(Defendant bears burden of production in support of inability defense and "burden shifts back to initiating party only upon a sufficient showing by the alleged contemnor"). When a defendant claims an inability to comply with the Receivership Order and turn over receivership assets, the key inquiry for the court is the credibility of the defendant's evidence.[9] *See, FTC v. Affordable Media, LLC,* 179 F.3d 1228, 1241 (9th Cir. 1999)(When a contempt deals with asset protection, "the burden on the party asserting an impossibility defense will be particularly high because of the likelihood that any attempted compliance with the court's orders will be merely a charade rather than a good faith effort to comply"); *United States v. Sorrells*, 877 F.2d 346, 350 n.4 (5th Cir. 1989) ("[T]he idea that the burden of production [for a contemnor] can be met only by the introduction of evidence that is credible seems beyond cavil"). Moreover, in order to prove an inability to comply with the Receivership Order, the contemnor must demonstrate a present inability to comply despite *all reasonable efforts in good faith. United States v. Ryan*, 402 U.S. 530, 534, 91 S.Ct. 1580, 1583, 29 L.Ed.2d 85 (1971); *Affordable Media, LLC,* 179 F.3d at 1241 ("[T]he party asserting the impossibility defense must show 'categorically and in detail' why he is unable to comply")(internal quotation omitted). Courts construe the "all reasonable efforts in good faith" requirement strictly. *United States v. Hayes*, 722 F.2d 723, 725-26 (11th Cir. 1984)("[A]ll reasonable efforts" requirement construed strictly, and "substantial", "diligent" or "in good faith" efforts do not satisfy burden); *Combs v. Ryan's Coal Co.,* 785 F.2d 970, 984 (11th Cir.), *cert. denied*, 479 U.S. 853, 107 S.Ct. 187, 93 L.Ed.2d 120 (1986)(Contemnor's 'substantial', 'diligent' or 'in good faith' efforts were not "all reasonable efforts" and thus failed to establish that the contemnor rebutted the *prima facie* showing of contempt).

Not surprisingly, banks, insurance companies, other commercial entities, and particularly persons who assisted the defendants in operating the fraud that gave rise to the receivership, often ignore a receiver's demand to remit to the receiver all receivership assets in their control. Nothing more effectively obtains immediate compliance with the Receivership Order's directives, however, than notice that the receiver will seek the coercive incarceration of the officers of a bank, the directors of an insurance company, or

[7] Notice of the hearing can be served through counsel if the target is represented.

[8] Because contempt proceedings are generally "highly factual", and "depend so heavily on complex facts not readily perceivable from the record" a Federal Rule 43(a) trial with oral testimony should be conducted to prove a contempt. *Sanders v. Monsanto Co.,* 574 F.2d 198, 200 (5th Cir. 1978).

[9] Sometimes, respondents may be so desperate to avoid compliance with the Order or incarceration for contempt, they literally manufacture evidence regarding their inability to comply with a Receivership Order. In one case a respondent was ordered to show cause for his failure to turnover hundreds of thousands of dollars in American Express traveler's cheques that were purchased with receivership funds. At the contempt hearing the respondent argued he no longer had the traveler's cheques and produced a letter he allegedly received the day before the hearing from the person to whom he claimed to have given the cheques and with whom he claimed not to have communicated with in more than three years. The letter read, "Hello, … It has been at least 3 years since we spoke. I heard from my friends that you are trying to find me. I am sorry for using most of the $750,000.00 in American Express Traveler Cheques I received from you and other funds I withdrew from the account to set up the trading infrastructure which would assist in the Trading of the MTM's. It just did not work out with the Muslim Trust, I am sorry. I owed someone money that found me and demanded his funds immediately or else, if you know what I mean, so I paid off my debt and got out of trouble. Now I am in trouble with you…"

individuals to whom the defendants transferred possession and control of receivership assets, until those persons comply with the Receivership Order.

4. Power Of Surprise

Another powerful weapon in a receiver's arsenal is the element of surprise. Most Receivership Orders are issued *ex parte*, with no notice to the defendants in receivership. Indeed, the *ex parte* nature of the proceedings is intended precisely to preserve the element of surprise so a receiver and the governmental agency instituting the action giving rise to the receivership have the best opportunity to keep assets and critical documents from being hidden, concealed, or destroyed.

When *"all assets"* of a defendant are placed in receivership, *"all assets"* includes the home of the defendant, or in cases in which a defendant is an entity, *"all assets"* includes the entity's office. Thus, upon issuance of the Receivership Order, the receiver becomes the owner of the house and the owner of the office premises, which includes the right to enter the home or office and change the locks of the premises, if necessary. In granting a receiver this power, Courts recognize that many defendants will not voluntarily and peacefully open the doors to their home or office to a stranger who introduces himself or herself as the newly appointed receiver entitled to possession and control over all of the defendant's assets. For this reason, Receivership Orders usually include language directing the United States Marshals to assist the receiver in carrying out his or her duties.

As a practical matter, immediately following appointment, a receiver should seek assistance from the United States Marshals in taking possession of the defendant's home and office. The United States Marshals take their responsibilities very seriously and recognize that enforcement of a Receivership Order presents a volatile and potentially dangerous situation. Thus, prior to a seizure of assets the United States Marshals usually try to determine whether the occupants of the house or office have a criminal history or history of violence, and whether they hold any gun permits. In some cases, prior to assisting a receiver with the seizure of a home or office, the United States Marshals will conduct an investigation of the surrounding area, identify retreat paths, and even inform the trauma units of the nearest hospitals to be on standby.

In the initial seizure of the home and office, the United States Marshals take the lead in identifying themselves to the occupants, demanding entry to the premises, and securing the premises before the receiver enters the house or office. If nobody is at the home or office at the time of the seizure, but the Receivership Order gives the receiver "possession and control" over the premises, the receiver has the authority to have a locksmith open the door and change the locks.

Defendants sometimes challenge a receiver's right to enter their home or office as an unconstitutional search or seizure. The argument fails, however. In *United States v. Setser*, 568 F.3d 482, 487-488 (5th Cir. 2009), *cert. denied,* 130 S.Ct. 437, 175 L.Ed.2d 299 (2009), the Fifth Circuit rejected the argument that the Fourth Amendment limits a receiver's right to assume possession of property as provided in an order of appointment. The court found that unlike government inspectors who are authorized to make unannounced and intrusive searches and inspections, receivers "take over property only after a court has agreed with the arguments and evidence that such a takeover is necessary" thus rendering any "constitutionally adequate substitute for a warrant" moot. *Id.* at 487. Further, in rejecting any defined particularity requirement for a Receivership Order, the Fifth Circuit found that "no court has ever held that the equivalent of a warrant must be issued in order for a receiver to be permitted to seize the property of the subject entity" because after appointment receivers often take possession of all property of the receivership entities, and such possession is the "central purpose for the appointment of a receiver." *Id.* at 488.

A receiver's chance of successfully recovering assets to return to claimants often requires a surprise seizure. Not only can a receiver freeze bank accounts before they have been emptied, but a receiver can obtain computers and documents containing fresh evidence of the defendant's most recent operations. Calendars, phone numbers, mail, and keys on a defendant's key ring often lead to the discovery of assets that would otherwise be concealed or hidden if a defendant had advance notice of a receiver's arrival.

5. Power To Recover Commissions Paid To Brokers

In most receiverships involving investor fraud, the defendants have paid substantial commissions to brokers who solicited investors for the fraudulent scheme. A receiver has the power to recover commissions from the brokers,[10] regardless of whether the brokers knew or reasonably should have known of

[10] Most Receivership Orders empower receivers to "initiate, defend, compromise, adjust, intervene in, dispose of or become a party to any actions or proceedings in state, federal or foreign courts necessary to preserve or increase the assets of the Defendants, to carry out his or her duties pursuant to this Order or to recover payments made improperly by the Defendants or entities in receivership…" This language authorizes the receiver to demand the return of commissions from brokers, and settle the claim or sue the brokers if the commissions are not returned.

the fraudulent nature of the investment. This power arises from the Uniform Fraudulent Transfer Act (the "UFTA"), which provides that a creditor[11] may recover transfers from the initial or subsequent transferees made with actual fraudulent intent, or transfers made with constructive fraud. Tex. Bus. & Comm. Code § 24.005(a)(1) and (2).

a. Transfers Made by Ponzi Schemes - "Actual Fraud" UFTA Claims

If the receivership defendants were operating a Ponzi scheme, the actual fraud claim under the UFTA is the easiest claim for a receiver to prove. Under the UFTA, actual fraudulent intent of the transferor operating the Ponzi scheme – the receivership entities or defendant who paid the commissions - exists as a matter of law. *Warfield v. Byron*, 436 F.3d 551, 558 (5th Cir. 2006)(Finding Ponzi schemes are insolvent from inception and thus every transfer made in furtherance of the fraud is made with actual fraudulent intent). Once fraudulent intent of the transferor is established as a matter of law, to avoid the receiver's recovery the recipient of the transfer (the brokers who received the commissions) must show he received the transfer of funds "in good faith" AND "in exchange for reasonably equivalent value."[12] Tex. Bus. & Comm. Code § 24.009(a); *Warfield,* 436 F.3d at 560.

In *Warfield ,* the Fifth Circuit held as a matter of law that regardless of whether a broker in a Ponzi scheme received commissions in good faith, he did not provide "reasonably equivalent value" by soliciting more investors (or victims) in the Ponzi scheme. In that case, the appellant Johnson received commissions from a massive Ponzi scheme that originated in Tacoma, Washington. He argued, in part, that he was not liable to the Receiver for the return of the commissions because he received the commissions in good faith without knowledge of the Ponzi scheme, and his brokerage services were value in exchange for the monies he received. Specifically, Johnson argued he spent hours of his time communicating with and soliciting investors, and filling out paperwork to facilitate their investments.

The primary consideration in evaluating reasonably equivalent value is "the degree to which the transferor's net worth is preserved." *Butler Aviation Int'l v. Whyte,* 6 F.3d 1119, 1127 (5th Cir. 1993). Broker services which merely expand the fraud are not reasonably equivalent value for the commissions paid to a broker, because the "services" merely increase the restitutionary claims owed by the receivership entities while depleting the entities' assets through payment of the commission. *Warfield,* 436 F.3d at 560.[13] In the Byron case, the Fifth Circuit concluded "[i]t takes cheek to contend that in exchange for the payments [Johnson] received, the RDI Ponzi scheme benefited from his efforts to extend the fraud by securing new investments.".

Likewise, to prevail in a defense of a receiver's actual fraud claim, the broker must also establish that he received the commissions in good faith. Tex. Bus. & Comm. Code § 24.009(a). "Good faith" under the UFTA is viewed objectively, and requires "honesty in fact." *In re Cohen*, 199 B.R. 709, 719 (B.A.P. 9th Cir. 1996)("One lacks the good faith that is essential to the UFTA § 8(a) defense to avoidability if possessed of enough knowledge of the actual facts to induce a reasonable person to inquire further about the transaction")*; see also*, *In re Sherman*, 67 F.3d 1348, 1355 (8th Cir. 1995)(Whether a transferee acts in good faith is determined by looking at what the transferee "objectively knew or should have known instead of examining the transferee's actual knowledge from a subjective standpoint"); *In re Agricultural Research & Tech. Group, Inc.*, 916 F.2d 528, 535-36 (9th Cir. 1990)(Court examines "what transferee objectively knew or should have known" in questions of good faith). In *Warfield,* although the Court declined to find the absence of good faith as a matter of law, it noted Johnson's failure to inquire about the defendant company for whom he was soliciting investments [and which was operating the Ponzi scheme] in light of "abundant suspicious information he possessed" about the people involved and their track record, "raised serious questions about his good faith defense." 436 F.3d at 560. Thus, although very difficult to prove at summary judgment (but not necessary if reasonably equivalent value is lacking), the absence of good faith is not an insurmountable hurdle. The broker may be found to lack good faith if he was not licensed to sell

[11] A receiver has standing to assert a fraudulent transfer claim on behalf of the receivership entity, or the entity's defrauded creditors. *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir.), *cert. denied, sub. nom, African Enter., Inc. v. Scholes,* 516 U.S. 1028 (1995) (Pursuant to his appointment, the receiver has standing to assert claims which benefit the receivership estate including fraudulent transfer claims); *Donnell v. Kowell,* 533 F.3d 762, 777 (9th Cir. 2008)(Finding receiver's standing to assert UFTA claims on behalf of Ponzi entities, once control persons were removed).

[12] The defendant broker bears the burden of proof regarding the exchange of value and his good faith. *Warfield,* 436 F.3d at 560.

[13] Importantly, some courts disagree with the Fifth Circuit's analysis and do not hold as a matter of law that broker's services in Ponzi schemes fail to provide reasonably equivalent value. *See, In re Fin. Federated Title & Trust, Inc.,* 309 F.3d 1325 (11th Cir. 2002); *In re First Commercial Mgmt. Group,* 279 B.R. 230 (Bankr. N.D. Ill, 2002); *Churchill Mortg. Ins. Group.,* 256 B.R. 664 (Bankr. S.D.N.Y. 2000).

securities; if the broker had access to suspicious financial data; was aware of a government agency's investigation of the receivership entity or the people operating it; or had knowledge or notice the entity was not operating as represented to the investing public.

b. Transfers Made by Non-Ponzi Entities – Constructive Fraud UFTA Claims

A receiver may also recover commissions paid to brokers in cases that do not involve Ponzi schemes. In the absence of a Ponzi scheme, however, a receiver often cannot prove as a matter of law[14] the transfer was made with "actual fraudulent intent", and thus must rely on the "constructive fraud" provisions of the UFTA. The statute provides for recovery of transfers made by a debtor who does not receive reasonably equivalent value in exchange for the transfer or obligation, when the debtor was insolvent at the time of the transfer, or reasonably should have anticipated his insolvency.[15] Tex. Bus. & Comm. Code § 24.005(a)(2); *Smith v. American Founders Fin. Corp.,* 365 B.R. 647, 666 (Bankr. S.D. Tex. 2007).

The UFTA utilizes both the balance sheet and the equity test for insolvency. *See,* Tex. Bus. & Comm. Code § 24.005(a)(2)(A) and (B). The equity test evaluates the debtor's inability to pay debts as they become due, which encompasses the "unreasonably small for the ongoing business" test, while the "balance sheet test" measures insolvency by comparing assets and liabilities. *See, In re Bay Plastics, Inc.,* 187 B.R. 315, 328 n. 22 (C.D. Cal. 1995)(Discussing various insolvency tests and finding that the UFTA uses both the "equity" and the "balance sheet" tests). In most instances of investment fraud, insolvency exists under both tests. Specifically, when investor funds are used by an entity contrary to the representation made to the investor, the existing assets of the entity (which often consists of investor funds only) are encumbered by restitutionary claims owing to the investors for the amount of the investments. *See, In re United Energy,* 944 F.2d 589, 595 (9th Cir. 1991)(Investors in a fraudulent scam own restitutionary claim up to the amount of their investment). In addition, rarely do the entities have a legitimate profit earned from the investors' funds from which to pay commissions,[16] or other ordinary bills and thus the payment of commissions merely deepen the receivership entities' insolvency.

Once insolvency is established, the receiver must also demonstrate that the broker's services were not the reasonably equivalent value of the commissions paid to the broker. As set forth above, in the Fifth Circuit, broker services furthering an illegal investment provide no reasonably equivalent value as a matter of law. *Warfield v. Byron,* 436 F.3d at 560 (Broker's efforts to secure new investments in illegal Ponzi scheme provided no value). Because receiverships are generally used when the investments at issue are illegal or fraudulent in some manner, this factor is rarely an issue.

In the rare circumstance where the investment is not illegal, or outside the Fifth Circuit, however, the receiver will need to establish that the commissions paid to the broker were not the equivalent of the value of the broker's services, by using market commission rates for brokers in similar fields with similar training. *See, In re Fin. Federated Title & Trust, Inc.,* 309 F.3d at 1332; *In re First Commercial Mgmt. Group,* 279 B.R. 230, 233 (Bankr. N.D. Ill. 2002) (Evaluating reasonably equivalent value of brokers services by comparing the services with "commissions paid to other individuals performing similar services" in the same industry); *World Vision Entertainment,* 275 B.R. 641, 657 (Bankr. M.D. Fla. 2002)(Analyzing value of broker services where brokers were paid "their normal fee for their usual services").

Finally, a receiver can sometimes recover his or her attorneys' fees in addition to recovering commissions paid to brokers. Texas' enactment of the UFTA allows a Court to award attorney's fees and costs incurred in pursuing a fraudulent transfer claim. Tex. Bus. & Comm. Code § 24.013 ("In any proceeding under this chapter, the court may award costs and reasonable

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[14] Actual fraudulent intent may of course be established by relying on the common "badges of fraud" listed in the statute, Tex. Bus. & Comm. Code § 24.005(b), but the existence of a Ponzi scheme eliminates the necessity for that factual inquiry.

[15] "(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or within a reasonable time after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: . . .

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(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(A) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(B) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due."

Tex. Bus. & Comm. Code § 24.005.

[16] Investment fraud usually is reported to governmental agencies because the investment is not returning the profits advertised to the investor.

attorneys fees as are equitable and just."). In some states, however, attorney's fees are not recoverable under the UFTA.

6. Power To Recover False Profits

If the receivership entities were operated as a Ponzi scheme, a receiver may also recover or "claw-back" the false profits paid to investors. Very simply, a Ponzi scheme has no legitimate profits to pay to investors. *See, Cunningham v. Brown,* 265 U.S. 1, 44 S.Ct. 424, 68 L.Ed. 873 (1924)(The original "Ponzi" case, in which the court found that the investment by its nature, was fraudulent from inception and resulted in no profits). Thus, when investors receive "interest" or "profits", the monies are in reality the principal investment of other investors. For this reason, a receiver has a duty to recover the false profits[17] from the "investment winners" so the monies may be distributed to the "investment losers" -- those who lost all or part of their principal investment in the Ponzi scheme. Equity mandates this result. It is patently unfair to allow some investors to profit when their "profit" is taken from another investor's principal investment.

Like recovering commissions from a broker, a receiver uses the Uniform Fraudulent Transfer Act to recover false profits from an investor. As noted above, because a Ponzi scheme is fraudulent from inception, the actual fraudulent intent of the transferor [operator of the Ponzi scheme] in transferring the false profits to the investor exists as a matter of law. *Warfield v. Byron*, 436 F.3d at 558; *In re Agricultural Research & Tech. Group, Inc.,* 916 F.2d at 534 (Debtor's intent to defraud is inferred from the existence of Ponzi scheme). Thus, in seeking the recovery of false profits from an investor, the receiver need only establish: 1) the existence of a Ponzi scheme; and 2) the amount of false profits received by the investor. The investor's defense is the same as the brokers': the false profits were received in good faith[18] and in exchange for reasonably equivalent value. *Scholes,* 56 F.3d at 754. Importantly, the investor's "innocence" or lack of knowledge that the investment was obtained by the defendant for a fraudulent purpose is irrelevant to a claim for the return of false profits, because the profits were not exchanged for reasonably equivalent value, and because "good faith" even if relevant, is measured objectively. *See Scholes*, 56 F.3d at 759-760.

The leading case addressing recovery of false profits in a Ponzi scheme context is *Scholes*. In *Scholes*, the Seventh Circuit held that a receiver could recover $300,000 in *false profits* received by an investor in the subject Ponzi scheme, holding such monies were undeniably obtained through "theft from other investors." *Id.* at 757. The *Scholes* Court held that even though the profits were "consideration" for the investor entrusting his investment to the debtor corporations, the investor's profits were not offset by any equivalent value to the estate because "a profit is not offset by anything; it is the residuum of income that remains when costs are netted against revenues. The paying out of profits to … [the investor] not offset by further investments by him conferred no benefit on the corporations but merely depleted their resources faster." *Id.*

Numerous authorities and common sense also defeat a frequent investor argument regarding entitlement to profits or interest: the profits were promised or based on a contract. Contracts for illegal purposes, however, are void. *Sender v. Simon,* 84 F.3d 1299, 1307 (10th Cir. 1996)("Courts will not aid in the enforcement of an agreement that was fraudulently procured in furtherance of an illegal purpose" even when the contract itself is not per se illegal); *In re Fink*, 217 B.R. 614, 622 (Bankr. C.D. Cal. 1997) (Investment contract which violated Rule 10(b)5 was an illegal contract and therefore was not a valid obligation providing offsetting antecedent debt exempting fraudulent transfer from trustee's recovery); *In re Randy,* 189 B.R. 425, 440-441 (Bankr. N.D. Ill. 1995)(Investment contract in Ponzi scheme is illegal and no value flows from it); *In re Taubman*, 160 B.R. 964, 982 (Bankr. S.D. Ohio 1993)(Contracts underlying Ponzi scheme are illegal); *see also, e.g., In re Trace Int'l Holdings, Inc.*, 289 B.R. 548, 560 (Bankr. S.D.N.Y. 2003)(Contract to pay dividends which is illegal as a result of corporation's insolvency is void and provides no antecedent debt for purposes of avoiding fraudulent transfer).

Logic and equity also support the legal result. If investors unwittingly financed complicated robberies

[17] Importantly, payments made to investors up to the amount of their principal payments are supported by the exchange of reasonably equivalent value since their principal investment creates a restitutionary claim up to the amount of the investment. For this reason, unless additional facts provide the basis for recovering "principal" payments, Receivers generally seek to recover only those amounts paid over and above an investor's principal amount.

[18] Although an investor's good faith is often not challenged by a receiver, good faith may not exist when the returns paid were unreasonably high compared to traditional returns or the returns defy reasonable explanation in light of the market during the relevant period. Simply turning a blind eye to the profits received so as to conveniently proclaim ignorance, is not "good faith". Since the question of whether an investor acted in good faith is usually a fact issue that precludes summary judgment, a receiver may concede this issue, however, simply because the investor cannot prove the funds were received in good faith AND in exchange for reasonably equivalent value.

pursuant to "investment" contracts, would a court look past the object of the contract to reward the investors with interest for the use of their money where the only source of the "interest" was the theft? No. Instead, courts acknowledge the investment creates an antecedent debt subject to a restitution claim, but the illegal contract creates no entitlement to profits or "interest" which qualifies as reasonably equivalent value. For instance, in *In re Cohen*, 875 F.2d 508, 511 (5th Cir. 1989), the Fifth Circuit held that a contract in an illegal Ponzi scheme creates no rights to "profits."

> "This reasoning [the lower courts' ruling that false profits were part of the transferee's "claim" which rendered the transferee a "creditor"] perpetuates the theory that the transaction between … [the debtor and the transferee] had economic substance and a profit potential. Contrary to this supposition, however, the bankruptcy court had already found that the stock reported as sold for …[the transferee] involved fictitious transactions for which … [the debtor] did not actually own sufficient amounts of stock to cover all of his customers' competing claims. If the transactions are consistently characterized as fraudulent, then … [the transferee's] claim against the estate derives from fraud and would seek no more than restitution of the amount he committed to … [the debtor]. Such a claim would generate no right by … [the transferee] to payment of stock sale "profits." On the other hand, even if … [the transferee's] investment created a contractual relationship with … [the debtor], … [the transferee] was not contractually entitled to receive "profits" on sales of stock that did not occur."

See also, In re Hedged-Investments Assoc., Inc., 84 F.3d 1286, 1290 (10th Cir. 1996)(Investor has no right to recover any amount in excess of principal investment, where the investment contract was illegal); *In re United Energy Corp.,* 944 F.2d at 595 (Holding that investments constituted reasonably equivalent value for payments up to the amount of the investments, but "excess amounts [received by investors over the amount of their investments] would be avoidable because the debtor would not have received reasonably equivalent value for them"). Most recently, in the massive Madoff Ponzi scheme, the Second Circuit upheld the Trustee Irving Picard's recommendation to limit claims of investors to only those monies lost, and not to include "lost profits". *In re Bernard Madoff Inv. Securities, LLC,* ___ F.3d ___, 2011 WL 3568936, *7 (2d Cir. Aug. 16, 2011).

A receiver's power to claw-back or recover false profits from investors in a Ponzi scheme is thus well recognized by the courts and supported by extensive case law.

7. Power To Recover Charitable Contributions Or Gifts

As cold-hearted as it may seem, a receiver not only has the power to recover commissions from brokers and false profits from investors, but may also recover charitable contributions or gifts made to third parties by a defendant in receivership. Even charities that are faithful stewards of the monies they receive are nevertheless liable to the receiver for the return of donations made by an individual or entity in receivership. Because investor funds were the source of the charitable donation, the charity received stolen money. In such instances, investors did not invest their money with the defendant to enable him or her to make a charitable contribution with the investor's funds. Thus, even the most well-meaning, legitimate and deserving charities and churches will be required to return donations received from defendants operating fraudulent investment scams.

In seeking the return of gifts or charitable contributions, a receiver relies upon the same well established law that allows a receiver to recover commissions or false profits. Under the Uniform Fraudulent Transfer Act, the transfer by the defendant operating a Ponzi scheme is fraudulent as a matter of law. Although the charity received the contribution in good faith and without knowledge of the Ponzi scheme, the charity did not provide any reasonably equivalent value in exchange for the monies received. *Scholes*, 56 F.3d at 759-760 (Gifts made to charitable organizations are not made in return for reasonably equivalent value and are recoverable by receiver for Ponzi scheme operation, because the UFTA makes no exceptions for the recovery of fraudulent transfers to innocent charities or religious organizations).

Indeed, pursuant to its nature as a "charity", the donors usually receive a receipt for the gift that includes confirmation that "no goods or services were provided in exchange for this contribution." Although the statement is intended to assist the donor in getting a tax deduction, it also, however, nails shut any potential argument regarding the exchange of value for the contribution. Because no goods or services were provided by the charity in exchange for the donation, as a matter of law the charity did not provide reasonably equivalent value and must return the funds.

The same theory extends to campaign contributions, and gifts of money or property to friends or relatives. To allow recipients of gifts derived from the proceeds of the defendant's fraud to retain those gifts "would allow almost any defendant to circumvent the SEC's power to recapture fraud proceeds by the simple procedure of giving the proceeds to friends and

relatives, even without their knowledge." *SEC v. George*, 426 F.3d 786, 798 (6th Cir. 2005) Indeed, even if the monies received as a gift or donation no longer exist or have been placed in an exempt asset, the recipient of the monies is liable to a receiver for the amount of the gift received. *See, e.g., Crawford,* 608 F.3d at 277-78 (Receiver was entitled to seize the home of the defendant's girlfriend because the mortgage on the home was paid by the defendant as a gift).

8. Power To Recover An Attorney's Retainer

At the time a person or entity is placed in receivership, any unused retainer monies held by attorneys representing the person or entity in receivership are recoverable by a receiver. Indeed, once the attorney receives notice of the receivership, the retainer monies are frozen and must be turned over to the receiver as property belonging to the receivership estate.[19] If legal services were provided prior to the receivership but not yet applied to reduce the retainer, the firm holding the retainer is generally required to obtain permission from either the receiver or the Receivership Court prior to transferring funds from an attorney's IOLTA account to an attorney's operating account. Otherwise, the attorney risks violating the Receivership Order which usually enjoins any activity that depletes Receivership Assets, including set-off, charging, or transferring funds. In requesting such permission, the attorney can argue that legitimate services were provided in exchange for the retainer he or she seeks to bill against. However, a receiver or a Receivership Court may still require a return of the full amount of the retainer and instruct the attorney to file a claim in the receivership to share in the distribution of the receivership estate with other creditors.

Upon learning they have been placed in receivership, most defendants immediately seek counsel. Counsel, in turn, usually require a substantial retainer as a condition to assuming such representation. If the attorney knows of the existence of a Receivership Order and accepts a retainer from the defendant, the attorney has an obligation to investigate the source of the retainer to insure the monies did not come from Receivership Assets. Such investigation requires more than the attorney simply asking a perfunctory question of the defendant. If the Receivership Court finds the attorney received a retainer from assets included within the scope of the Receivership Order and the attorney did not conduct an adequate investigation of the source of the retainer, the court may compel the attorney to disgorge the monies received, even if legal services were provided in exchange for the monies.

In *Federal Trade Commission v. Assail, Inc.,* 410 F.3d 256 (5th Cir. 2005) the Fifth Circuit held that an attorney has a duty to investigate the source of the funds with which a client pays its fees to insure the funds are not tainted and are not subject to an order of the court freezing the funds in a receivership. "[A]n attorney must 'audit' a client sufficiently so as to avoid becoming part of a criminal scheme that includes disposing of ill-gotten gains." 410 F.3d at 264. Accordingly, a lawyer cannot make himself willfully ignorant of the circumstances surrounding the source of his fees in a situation in which assets have been frozen. "[W]hen an attorney is objectively on notice that his fees may derive from a pool of frozen assets, he has a duty to make a good faith inquiry into the source of those fees. Failure to make such an inquiry in the face of this duty will result in disgorgement of the funds." 410 F.3d at 265; *see also, In re Bell & Beckwith,* 838 F.2d 844 (6th Cir. 1988)(Attorney who received fees from client whose assets were in receivership "was under a duty of inquiry as to the source of his fees"); *SEC v. Princeton Economic Int'l, Ltd.,* 84 F.Supp.2d 443, 446, 447 (S.D.N.Y. 2000)("A lawyer who blindly accepts fees from a client under circumstances that would cause a reasonable lawyer to question the client's intent in paying the fees accepts the fees at his peril"); *In re Moffitt, Zwerling & Kemler, P.C.,* 846 F.Supp. 463 (E.D. Va. 1994)(Requiring forfeiture of funds paid to firm that made no effort to ascertain the source of funds paid by defendant indicted for sale of narcotics).

Moreover, there is no "right to counsel" in a civil case, particularly where counsel would be paid from funds derived from the defendant's fraud. *United States v. 30.64 Acres of Land,* 795 F.2d 796, 801 (9th Cir. 1986); *Willis v. FBI,* 274 F.3d 531, 532 (D.C. Cir. 2001)(Civil litigants have no constitutional entitlement to counsel); *CFTC v. Noble Metals, Int'l, Inc.,* 67 F.3d 766, 774 (9th Cir. 1995)("A district court may, within its discretion, forbid or limit payment of attorney fees out of frozen assets," particularly where the frozen assets "fell far short of the amount needed to compensate [the defendants' defrauded] customers"); *Alsco-Harvard Fraud Litig.*, 523 F.Supp. 790, 799-800 (D.C. Cir. 1981)(Litigants not faced with the possibility of losing their physical liberty, even if indigent, have no right to counsel, and defendants whose only assets available for paying an attorney were attached by the IRS, were not deprived of due process or otherwise entitled to attack motion for summary judgment

[19] Some states allow attorneys to deem retainers "earned on receipt," regardless of whether the attorney has actually billed any time. While this practice may impede a traditional garnishment, it will not hinder a receiver's recovery because such funds would not have been exchanged for value until services are provided, even if the retainer becomes the attorney's property rather than funds owned by the entity in receivership.

premised on lack of counsel). Likewise, even in instances where a criminal case is filed contemporaneously with a civil case, a defendant does not have the right to pay his counsel with ill-gotten funds. *Caplin & Drysdale, Chartered v. United States,* 491 U.S. 617, 624-26, 109 S.Ct. 2646, 105 L.Ed.2d 528 (1989)("A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that defendant will be able to retain the attorney of his choice"); *United States v. Dupree,* ___ F.Supp.2d ___, 2011 WL 1004824 *20 (E.D. N.Y. Mar. 18, 2011)("[A] defendant has no Sixth Amendment right to funds that are the proceeds of the charged fraudulent conduct, even if the funds are necessary to retain counsel of choice").

As a practical matter, a receiver should, at the initial stages of the receivership send a letter to the attorneys representing the defendants in receivership to obtain evidence of the source of the retainer paid to the attorneys. Such information is not privileged. *In re Grand Jury Subpoena for Attorney Representing Criminal Defendant Reyes-Requena,* 913 F.2d 1118, 1123 (5th Cir. 1990)(Holding that "matters involving the payment of fees and the identity of clients are not generally privileged."). To avoid forfeiting fees earned but paid from fraudulently obtained funds, attorneys representing defendants placed in receivership must insure someone other than the defendant in receivership confirms the clean source of funds paid to the attorney.

9. Power To Escape Bankruptcy

Because of the powers granted to receivers and the mystery surrounding receiverships, defendants often prefer bankruptcy to receivership. Likewise, the target of a receiver's recovery efforts may seek bankruptcy protection. Federal district courts' oversight of bankruptcy courts and exemptions under the Bankruptcy Code, however, provide the means for a receiver to escape the limitations of bankruptcy.

Receivership Orders usually include language prohibiting the receivership defendants from filing bankruptcy without the Receivership Court's permission, and enjoining the defendants' creditors from putting the defendants into an involuntary bankruptcy.[20] Such provisions are intended to insure the Receivership Court remains the exclusive jurisdiction for the receivership estate unless good cause is shown to the Receivership Court to allow a bankruptcy filing. *SEC v. Byer*, 609 F.3d 87, 92-93 (2d Cir. 2010)(Upholding the right of a district court to enter an "anti-bankruptcy injunction" as part of its "broad equitable powers in the context of an SEC receivership"); *see also*, *United States v. Royal Business Funds Corp.,* 724 F.2d 12, 15 (2d Cir. 1983)("A debtor subject to a federal receivership has no absolute right to file a bankruptcy petition and federal courts have disallowed petitions where liquidation under a receiver is substantially under way"). Indeed, after the issuance of a Receivership Order, which includes an injunction against filing bankruptcy, the act of filing bankruptcy constitutes disobedience of the Receivership Order and creates grounds for contempt proceedings.

Further, once a Receivership Order is entered, the receiver is in control of the person or entity in receivership and the receiver may dismiss the bankruptcy. Alternatively, a receiver may request the district court to withdraw the reference of the case to the bankruptcy court so the bankruptcy case will proceed before the district court. Withdrawal of the reference is mandated in a receivership because the district court has already assumed exclusive jurisdiction of the assets of the debtor pursuant to the Receivership Order. *See* 28 U.S.C. § 157(d) (The district court *shall*, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both Title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce) (emphasis added). Because both federal receivership laws and Title 11 must be considered together in dealing with the debtor, withdrawal of the reference is proper.

Sometimes a defendant, in anticipation of being placed in receivership, files bankruptcy as a pre-emptive strike prior to issuance of a Receivership Order. The filing of bankruptcy, however, does not stay a district court from issuing a Receivership Order where the order is an exercise of a governmental agency's regulatory power. 11 U.S.C. § 364(b)(4); *SEC v. First Fin. Group*, 645 F.2d 429, 439-440 (5th Cir. 1981)(Finding no error in district court's appointment of receiver in enforcement case filed subsequently to involuntary filed Chapter 11 bankruptcy); *SEC v. Towers Fin. Corp.,* 205 B.R. 27, 29-30 (S.D. N.Y. 1997).

[20] An example of such language is contained in the *Order Appointing Receiver* entered in *SEC v. Alan Todd May, et al;* Civil Action No. 3:10-CV-0425-L in the United States District Court for the Northern District of Texas, Dallas Division, which states: "Defendants, and their respected agents, officers, and employees and all persons in active concert or participation with them are herby **prohibited** from doing any act or thing …to interfere in any manner with the exclusive jurisdiction of this court over the Receivership Estate, including…any proceeding initiated pursuant to the United States Bankruptcy Code, except with the permission of this court." (emphasis added).

Third parties who are not in receivership, but who find themselves the target of a receiver's action to recover commissions, false profits, or charitable gifts, often times seek to have their obligation to the receiver discharged by filing Chapter 7 bankruptcy. Thanks to the Sarbanes-Oxley Act, which modified the exemptions to bankruptcy discharges, such liability is generally no longer dischargeable.

The Sarbanes-Oxley Act added Section 523(a)(19) to the Bankruptcy Code, and exempts from discharge a debt that: (1) arises from violations of a securities law or from fraud in connection with the purchase or sale of a security, and (2) results from a judgment entered in a judicial proceeding. 11 U.S.C. § 523(a)(19). A receiver may rely upon this provision in seeking to declare his claim against a third party nondischargeable.

The targets of a receiver's recovery efforts most often argue they did not commit securities fraud and that Section 523(a)(19) is therefore inapplicable. On its face, however, Section 523(a)(19) does not require that the *debtor in bankruptcy* commit the securities violations from which the debt arises. Instead, the debt must simply "arise" from securities law violations or fraud in connection with the purchase or sale of a security, which then results in a judgment or other enforceable agreement or order. If Congress had intended Section 523(a)(19) to apply only to securities violations "*by the Debtor*", Congress could have easily inserted such words into the statute. *See, Union Bank v. Wolas*, 502 U.S. 151, 158, 112 S.Ct. 527, 530 (1991)(Congress' failure to foresee "all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning," and request to add limiting language to a statute implies an "exceptionally heavy" burden); *In re Jafari*, 401 B.R. 494, 499 (D. Colo. 2009)("Rather than speculating on Congress' intent, this Court must construe the language as it was actually written.")

A receiver can file an adversary proceeding in the bankruptcy, and rely upon the Receivership Order as evidence the debt owing to the receiver by the debtor in bankruptcy "arises out of securities fraud."[21] The Receivership Order demonstrates the purpose of the receiver's appointment was to recover monies stolen through securities fraud, and the receiver provides additional evidence of the stolen monies traced to the debtor in the form of commissions, false profits, or gifts. Moreover, a receiver can demonstrate to a bankruptcy court that the monies the receiver seeks to recover from the debtor will be used to reimburse the victims of securities fraud. Indeed, in many cases the monies a receiver recovers and returns to defrauded investors are credited against the restitution judgment entered against the violator of the securities laws, a result consistent with the very purpose of Section 523(a)(19). *See, In re Gibbons*, 289 B.R. 588, 591-92 (Bankr. S.D. N.Y. 2003) (Sarbanes-Oxley Act exemption was intended to provide the broadest possible protection for investors seeking to recover debts that arose from securities violations); *see also, SEC v. Kenton Capital, Ltd.,* 69 F.Supp.2d 1, 15 (D.D.C. 1998)(Setting disgorgement amount as the difference between the funds collected by the defendant and the funds re-paid to the investors); *SEC v. Chemical Trust,* 2000 WL 33231600 (S.D. Fla. Dec. 19, 2000)(Reducing defendant's disgorgement obligation by amount that will eventually be returned to the investors).

In addition, the definition of "judgment" under Section 523(a)(19) includes "any judgment, order, consent order, or decree entered in any Federal or State judicial proceeding… or any court order…." entered "before, on, or after the date on which the petition was filed."[22] The "judgment" relied upon by a receiver in contesting discharge of the debtor is the "judgment" entered against the defendant in the receivership action because Section 523(a)(19) does not require that the "judgment" be against the debtor. Thus, a receiver may effectively argue that the debtor's obligation to the receiver is an obligation to the defrauded investors who were the victims of the securities fraud committed by the receivership defendant and against whom a securities fraud judgment or other disgorgement or restitutionary order has been entered. *See e.g., In re Civello*, 348 B.R. 459, 466 (Bankr. N.D. Ohio 2006)(Finding that cease and desist order lacking any benefit to victims of securities fraud nonetheless qualified as "judgment" under 11 U.S.C. 523 (a)(19)).

10. Power To Open Mail

A Receivership Order often includes language specifically empowering a receiver to obtain and open the defendant's mail. Upon his or her appointment, a receiver executes a change of address card and provides a copy of the Receivership Order to the Postal Service directing delivery of all future mail to the receiver's address instead of the defendant's address. Upon receipt, the receiver has the authority to open the mail. Credit card statements, telephone bills, bank statements, and letters are all helpful in revealing to a receiver critical information regarding the location of assets.

If a Receiver receives any mail directed to a defendant that indicates the defendant may be harmed (by angry investors for instance), a receiver has a duty

[21] Interesting arguments exist regarding application of the exemption to commodities or other types of fraud, which are not strictly "securities" fraud.

[22] 11 U.S.C. § 523(a)(19)(B)(i) and (iii).

to immediately inform the defendant and law enforcement. As an example, in a $78 million commodities Ponzi scheme case in the United States District Court for the Eastern District of Texas, the Receiver intercepted mail addressed to the defendant. The envelope contained no return address. Inside the envelope was a single piece of paper with the hand written words in all capital letters "DEAD MAN WALKING". The Receiver immediately sent a copy of the note to the defendant's attorneys and to the FBI agent assigned to the case.

III. CONCLUSION

Entry of a Receivership Order provides a receiver with ample ammunition to collect and liquidate Receivership Assets. Further, the injunctive nature of a Receivership Order and certain jurisdictional statutes enable receivers to obtain jurisdiction over persons and property regardless of where in the United States the Receivership Assets or persons holding those assets are located. The threat of contempt for failing to comply with a Receivership Order's command to turn over Receivership Assets and records to the receiver compels most persons and entities to comply with the Receivership Order. The element of surprise, which generally exists with an *ex parte* receivership appointment, allows the receiver to seize and secure assets and records before they can be hidden, dissipated or destroyed by the defendants. Moreover, the threat of contempt for defendants who control off-shore assets, and creative remedies directed to foreign entities often enable receivers to recover assets located outside of the United States. The growing body of case law addressing a receiver's right to recover false profits, commissions, and charitable contributions or gifts also arm a receiver with authorities necessary to recover Receivership Assets transferred to investors, brokers, charities, or non-parties. The Sarbanes-Oxley fraud exemption to the Bankruptcy Code allows receivers to avoid discharge of their claims in bankruptcy, and the injunctive provisions of the Receivership Order protect the receiver from the loss of control by preventing the transfer of Receivership Assets into bankruptcy estates. The receiver's ability to intercept and open mail provides him with crucial information that defendants are often unwilling to voluntarily disclose. Each of these weapons is crucial to a receiver's ability to effectively and efficiently accomplish the purpose of his appointment: recovery and liquidation of a fraud-feasor's assets for distribution to the defendant's defrauded victims.

Although a receiver's powers are vast and oftentimes ambiguous, experience dictates that the traditional breadth of the Receivership Order is necessary to address the virtually limitless challenges faced by an equity receiver.[23] Defendants are not limited in the means and methods employed to impede a receiver's efforts to recover the proceeds of their fraud, and courts recognize that to succeed in their duties receivers must be authorized with the greatest breadth and flexibility permitted by equity. Nonetheless, a receiver's authority is not unlimited: he answers to the court for all of his actions and must periodically report to the court regarding his progress and provide accountings summarizing his expenses and recoveries; his fees are only paid after court approval; and many activities, such as selling real property, require a hearing and specific court approval.

The numerous powers at a receiver's disposal dictate use of a cost-benefit analysis to decide which activities will result in a net benefit to the estate, and which are merely rabbit-trail distractions. Efficient and effective execution of a Receivership Order requires diligence, discretion, imagination, and above all, continued awareness that the receiver serves for the benefit of the defrauded investors and creditors. The tools discussed above, however, together with a constant awareness of the importance of equitable considerations, empower a receiver to successfully perform his duties.

[23] As the court's agent, a receiver shares the court's absolute immunity for liability arising from the "faithful execution" of his duties. *Davis v. Bayless,* 70 F.3d 367, 373 (5th Cir. 1995); *New Alaska Dev. Corp. v. Guetschow,* 869 F.2d 1298, 1303-04 (9th Cir. 1989).