

COVID-19: Fraud Schemes, Relief Act Forgiveness Fraud, and International Commercial Fraud Issues

Speakers on Today's Program



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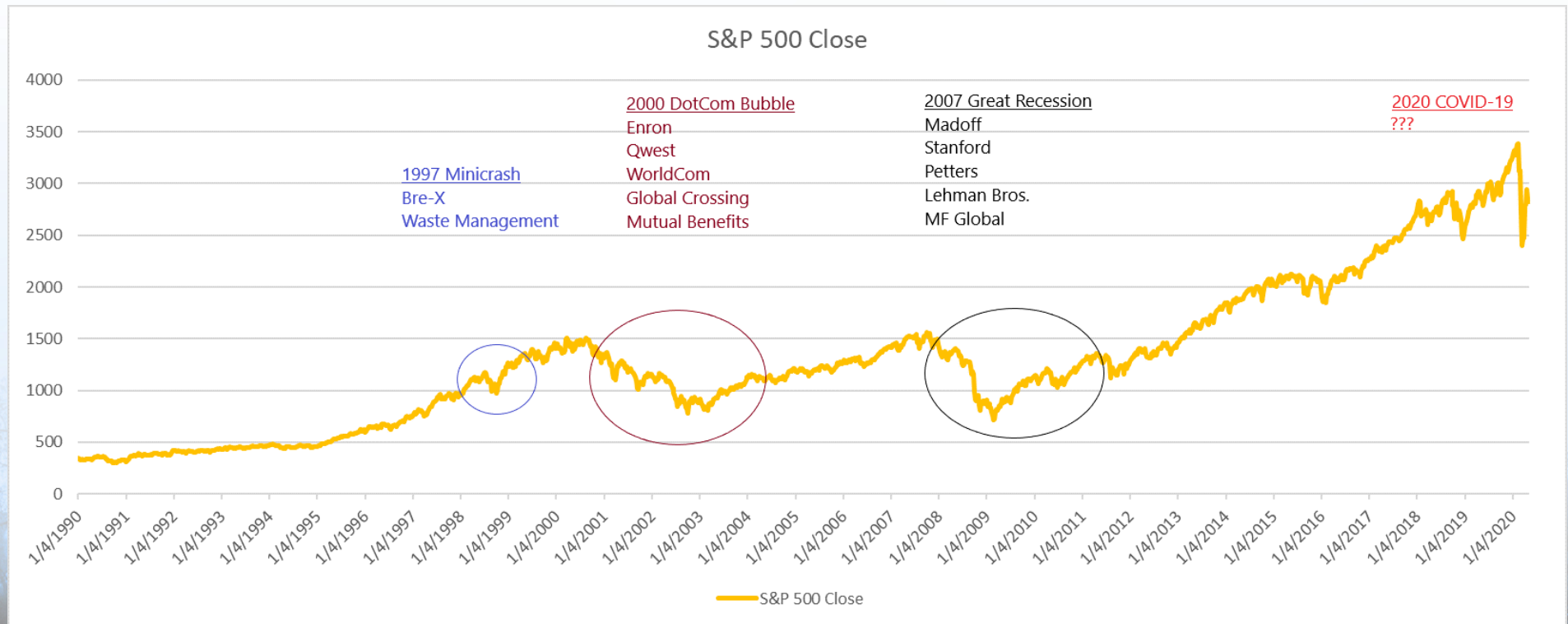
Fraud is Rising

A Unique Combination of Social and Economic Factors Lead to More Fraud



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Economic Uncertainty Breeds Fraud





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COVID-19 Exposed Frauds

- International Monetary Fund

“It is very likely that this year the global economy will experience its worst recession since the Great Depression, surpassing that seen during the global financial crisis a decade ago.”

- Warren Buffett

“You only find out who is swimming naked when the tide goes out.”

- 2008 Financial Crisis exposed many fraudulent schemes:

- Credit tightened
- Investors seek to redeem
- Fraudster seeks to bring in new money
- Schemes exposed when redemption cannot be paid

Fraud Risk Factors

Why people become victims

- Greed
- Fear
- Loneliness
- Ignorance
- Gullibility

Why people become perpetrators

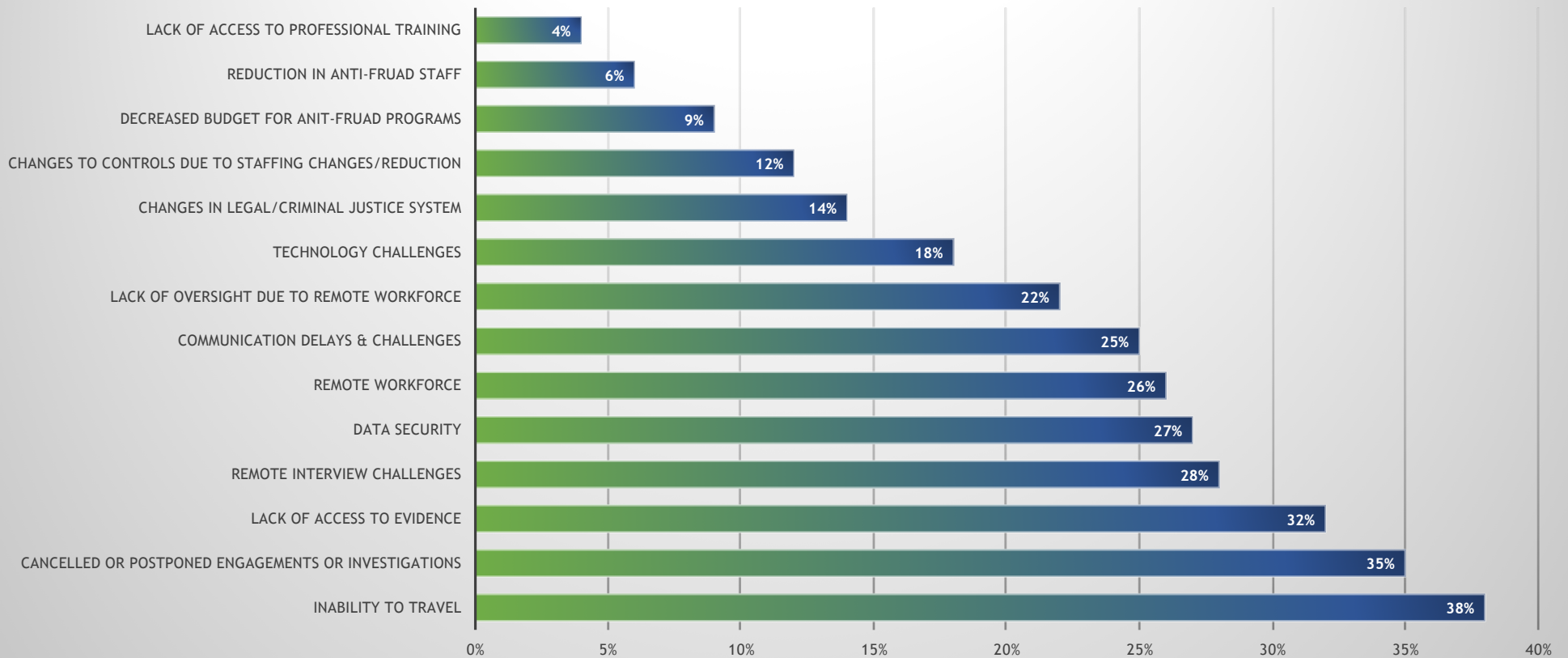
- Greed
- Fear
- Opportunity



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Most Prominent Challenges in Combating Fraud In The Wake of COVID-19

ACFE COVID-19 Benchmark Report



Investment Schemes

- Precious metals, gems, coins, stamps and other collectible items
- Currency trading including Forex and cyber currencies
- Distressed debt and financial instruments
- Oil, gas and real estate
- Blue Sky schemes involving pharmaceuticals, medical devices (including virus tests, vaccines and PPE)

Business Fraud

- Balance sheet fraud
- Valuation fraud
- Vendor fraud
- Theft and embezzlement
- Phishing scams
- PPP/EIDL Fraud



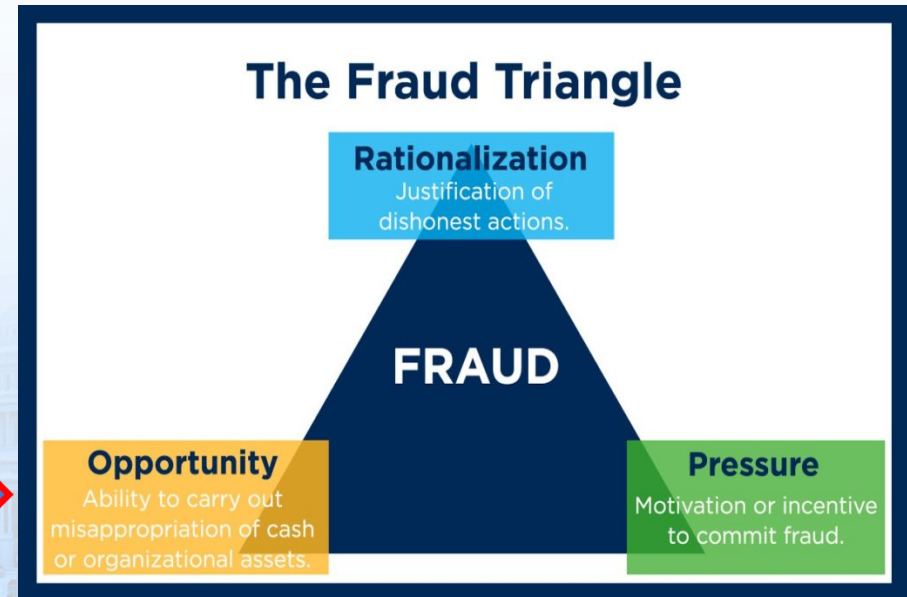
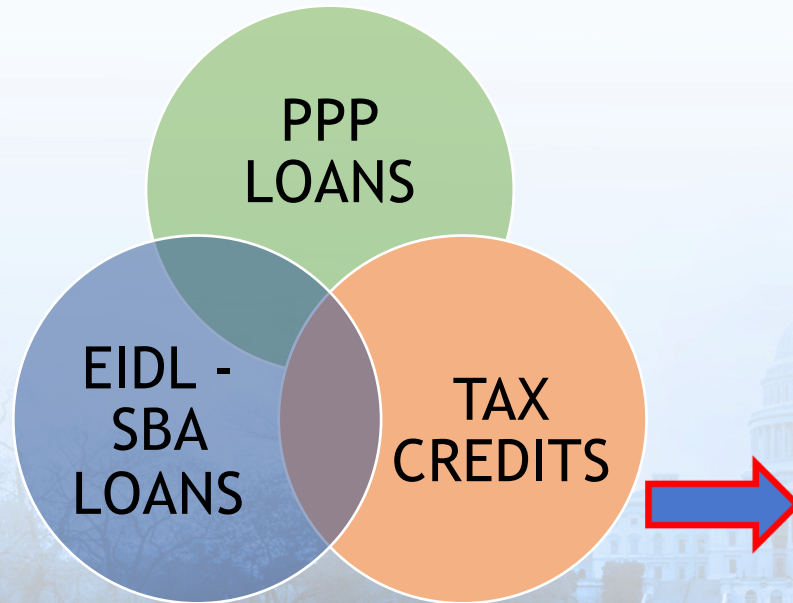
TOP FRAUD SCHEMES CURRENTLY OBSERVED DUE TO CORONAVIRUS (ACFE)

- **Cyberfraud – Specifically Email Phishing**
 - US Treasury alert to accounting firms
- **Fraud by Vendors & Sellers (use of SBA PPP/EIDL for “allowable” Uses)**
- **Payment Fraud – Wages, Bonuses, Prepayments, Loans and Durable Goods**
- **Health Care Fraud**
- **Identity Theft**



BASED ON DATA FROM FRAUD IN THE WAKE OF COVID-19: BENCHMARKING REPORT ~ [ACFE.COM/COVIDREPORT.ASPX](https://www.acfe.com/covidreport.aspx)

INTERSECTION OF PPP - SBA - TAX CREDITS FROM CARES AND FAMILY FIRST ACTS





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PPP “FORGIVEABLE LOANS” AND EIDL LOANS/GRANTS ADMINISTERED BY SBA

Allowable Use Loan Terms and Interest Rates:

- PPP: 1% 2-5 years on Non-Forgiven Disbursements
- EIDL: 3.75% Up to 30 years (2.75% non-profit)

- Contact Ginny Tate for Cares and Families First Acts terms, tax and use relationship chart.

Allowable but Not Forgivable - Limits by % Overall Forgivability

Do Illegal Uses Trigger Immediate Loan Repayment?

Illegal Uses of PPP:

- Offshore employees
- Social Security and Income Tax Withholding
- Wages used for Sick Leave or FMLA Tax Credits
- Fraudulent Uses
- Prepayment of interest and/or principal of mortgages

PPP & EIDL UPDATES

June 5, 2020 Updated Forgiveness Rules:

- Expands Covered Period from 8 to 24 Weeks
- Lowering minimum loan amounts required for Payroll from 75% to 60%
- Extends repayment from 2 to 5 years post 6/5 loans
- Extends Safe Harbor deadline to rehire to 12/31/2020
- Official Guidance yet to be released as of 8/19/2020
- <\$150,000 PPP loans may receive automatic forgiveness under bipartisan bill "The Paycheck Protection Small Business Forgiveness Act"

SUSPICIOUS ACTIVITY IDENTIFIERS

Task Forces initiated by SEC, FBI, State AG's False Claims Act – Utilization against fraudsters/violators

- Use of stolen identities, EIN or SSN to qualify
- Purported businesses, including front or shell companies, lacking indicia of operating presence
- Applicants utilizing 3rd parties in exchange for % of funds
- Account victims of social engineering schemes
- Identity Theft - Customers reporting to financial institution of received funds noting SBAD TREAS 310 and Origin No. 10103615 but did not apply for COVID-19 Loan
 - Customer not known to be a small business receives above funds
 - New customer receives above described funds
 - Single accountholder receives multiple EIDL/PPP loan deposits
- Receipt of funds when customer application for PPP has been denied



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PPP-EIDL HURDLES: FRAUDULENT USE CHALLENGE AREAS

- Application Fraud
 - False Employees
 - False Payroll Values

- Loan Proceed Uses
 - Social Distancing and PPE Costs
 - Working Capital
 - Related Party/Employee Loans
 - Prepayments of loans or other costs
 - Employee Retention
 - Bonuses
 - Vendors & Contractors
 - Multiple Entities



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PPP-EIDL HURDLES: OWNER/OFFICER COMPENSATION

➤ Owner - Employee (S or C Corp)

Based on 8/52 of 2019 compensation (15.38%)

Prior year base limited to \$100,000 - therefore maximum is \$15,385 in total across ALL businesses

➤ Sole Proprietor Limits*

Capped at owner compensation replacement based on 2019 net profit

➤ General Partners/Members*

Net Earnings from Self-Employment reduced by

- claimed Sec 179
- Unreimbursed partnership expenses
- Depletion
- Multiplied by .9235

****No additional forgiveness for retirement or health insurance contributions for self-employed (SCH C, General/Managing Partners) as this is deemed to be paid out of net self-employment income.***

Fraud & Bankruptcy

Fraud always presents challenges - the CARES Act adds to them

Fraud brings challenges in Bankruptcy Cases

- Ownership of assets is uncertain
- Core contractual relationships may not be enforceable or even real
- Business/accounting records do not match reality - if they exist at all
- Money is missing



Recovering money in Bankruptcy

- Suits against principals
- Suits against professionals
- Fraudulent Transfer/Preference Litigation



Suits against professionals

- Existence of a duty to the plaintiff
- Causation
- Standing
- In pari delicto



Fraudulent transfers

- ***Ponzi presumptions***

- First, transfers in furtherance of a Ponzi scheme are made with an actual intent to hinder, delay or defraud a creditor.
- Second, the operator of a Ponzi scheme (the debtor) is insolvent at all relevant times. Insolvency for this purpose is defined as inadequate capitalization or taking on more debt than can reasonably be paid. UFTA, § 4(a)(2), Code §§ 548(B)(ii)(II)-(III).
- Third, the payments of gains to investors or commissions to sales agents are transfers without the receipt of equivalent value.

Fraudulent transfers - International Issues

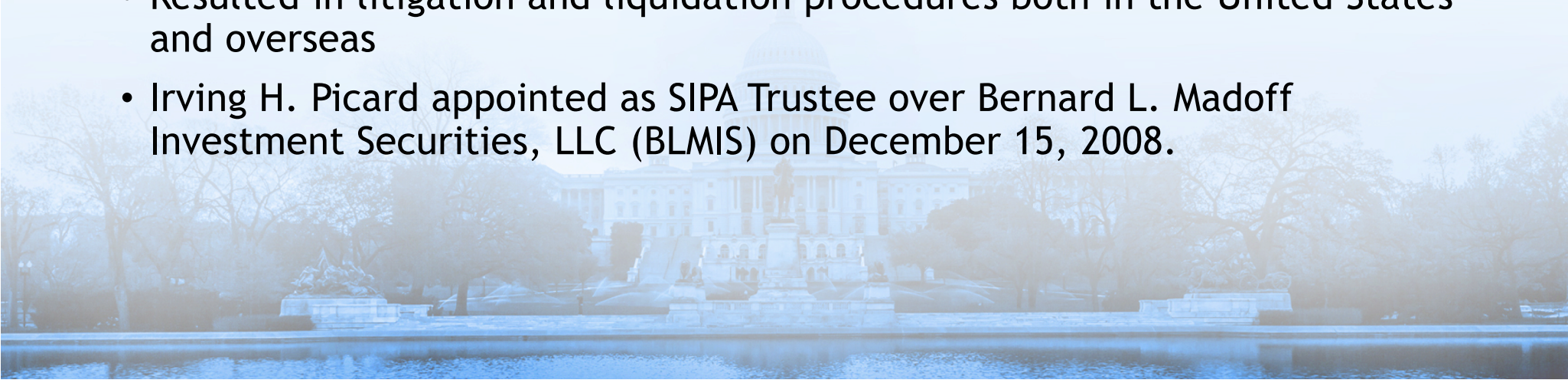
- International reach of US fraudulent transfer laws/actions
- Conflicts of laws issues in multi-national fraud cases



Bernie Madoff



- Largest Ponzi scheme in history
- Promised returns that seemed / were too good to be true
- Fraudulent scheme collapsed when market collapsed in 2008
- Resulted in litigation and liquidation procedures both in the United States and overseas
- Irving H. Picard appointed as SIPA Trustee over Bernard L. Madoff Investment Securities, LLC (BLMIS) on December 15, 2008.





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Feeder Structure Chart



*In Re: Irving Picard, Trustee for Liquidation of Bernard L.
Madoff Investment Securities LLC/United States Court of
Appeals for the Second Circuit - Courts Below*



- Trustee (Irving Picard) sued for foreign subsequent transferees under §550(a)(2) of the Bankruptcy Code
 - a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court orders, the value of such property, from---
 - (1) The initial transferee of such transfer or the entity for whose benefit such transfer was made, or
 - (2) Any immediate or mediate transferee of such initial transferee



Courts Below, cont'd

- §548(a)(1)(A): The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within two years before the date of the filing of the petition, if the debtor voluntarily or involuntarily---
 - (A) made such transfer or incurred such obligation with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted, or



Courts Below, cont'd

- U.S. District Court for SDNY held that the Trustee could not proceed with the actions on the grounds that:
 - a) The presumption against extraterritoriality prevents the Trustee from recovering property that a foreign entity received from another foreign entity;
 - b) The scope of §550(a)(2) is limited by the principles of international comity
- Proceedings were remanded to the Bankruptcy Court for the SDNY.
- Bankruptcy Court dismissed the claims on same grounds.

In Re: Irving Picard, Trustee for Liquidation of Bernard L. Madoff Investment Securities LLC/United States Court of Appeals for the Second Circuit



- Trustee appealed orders dismissing actions and appeals were consolidated
- Presumption against extraterritoriality
 - Look at focus of statute / cannot “analyze the provision in a vacuum”.
 - The Bankruptcy Code’s avoidance (§548) and recovery (§550) provisions work in tandem
 - §548 concerned with initial transfer as it is the only transfer made by the debtor
 - Transfers to feeder funds are a domestic activity regulated by §550
 - Madoff Securities was a domestic entity; and
 - Property transferred from U.S. bank account to feeder funds.



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In Re: Irving Picard, Trustee for Liquidation of Bernard L. Madoff Investment Securities LLC/United States Court of Appeals for the Second Circuit - cont'd



- International Comity
 - Prescriptive comity: “No bar to recovery when the trustee of a domestic debtor uses §550 to recover property from a foreign subsequent transferee on the theory that the debtor’s initial transfer of that property from within the United States is avoidable under §545(a)(1)(A).”
- Vacated Bankruptcy Court’s judgments dismissing the Trustee’s actions, permitting the Trustee to recover funds from subsequent transferees.

In Re: Irving Picard United States Supreme Court



- Filed Petition for Writ of Certiorari on August 29, 2019
- *Amicus curiae* briefs filed by various offshore Governments (Cayman Islands Government and Government of BVI) and by overseas insolvency and financial organizations (Cayman Finance / RISA Cayman, RISA Bermuda and BVI Restructuring Professionals) arguing that the 2nd Circuit's decision will have a disruptive and detrimental effect on insolvency proceedings in foreign countries, that it violates the principles of comity, and that the expansion of §550 (a)(2) to include extraterritorial application is unnecessary.
- Petition denied on June 1, 2020

Cayman Islands - Insolvency Regime

- *Companies Law (2020 Revision)*
- Winding-up petition and appointment of provisional liquidator (s. 104) on grounds that:
 - Case for making winding-up order (i.e. just and equitable as a result of loss of confidence in company management resulting from fraud, mismanagement or misconduct); and
 - Appointment of provisional liquidator is necessary to:
 - Prevent the dissipation of a company's assets;
 - Prevent the oppression of minority shareholders; or
 - Prevent the mismanagement or misconduct on the part of the company's directors.
 - Appointment of official liquidator.

Cayman Islands - Insolvency Regime

- Functions and powers of official liquidators (s. 110)
 - Collect, realise and distribute the assets of the company to its creditors
 - Report to the company's creditors and contributories upon the affairs of the company and the manner in which it has been wound up.
- Liquidator may require a Statement of Affairs (s. 101)
 - Include: assets/liabilities, names and addresses of persons having possession of company assets, assets of the company held by those persons, etc.
- Power to investigate and prosecute (s. 102)

Cayman Islands - Insolvency Regime

- **Voidable Preference (s. 145)**
 - Every conveyance or transfer of property, or charge thereon, and every payment obligation and judicial proceeding, made, incurred, taken or suffered by any company in favour of any creditor at a time when the company is unable to pay its debts within the meaning of section 93 with a view to giving such creditor a preference over the other creditors shall be invalid if made, incurred, taken or suffered within six months immediately preceding the commencement of a liquidation.
- **Avoidance of dispositions made at undervalue (s. 146)**
 - Every disposition of property made at an undervalue by or on behalf of a company with intent to defraud its creditors shall be voidable at the instance of its official liquidator.
 - No action or proceedings shall be commenced by an official liquidator under this section more than six years after the date of the relevant disposition.

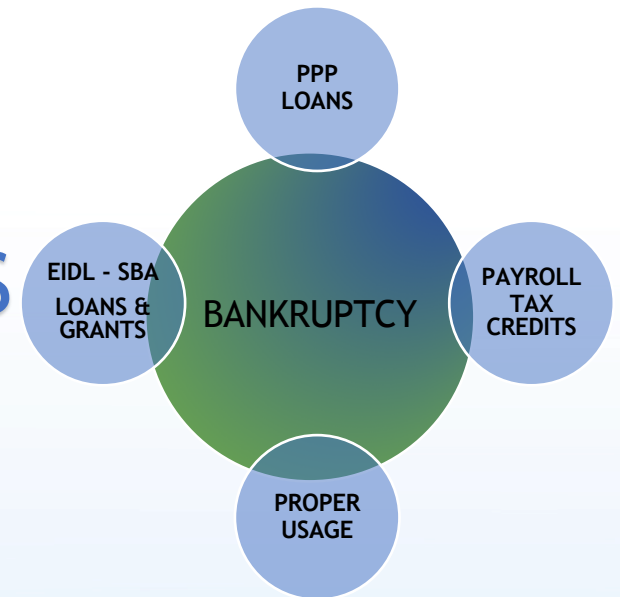


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Recognition of US Insolvency Proceedings in the Cayman Islands

- Cayman Islands not a signatory to UNCITRAL Model Law on Cross-Border Insolvency
- Similar to Chapter 15 - Ancillary orders to aid a recognized foreign insolvency proceeding
- Part XVII - International Co-operation provisions of the *Companies Law*
- *Foreign Bankruptcy Proceedings (International Co-operation) Rules, 2018*

PPP-EIDL BANKRUPTCY CONCERNS



- Owners do NOT guarantee PPP loans
- PPP No Collateral - Non-Recourse Loans
- EIDL Requires Collateral and Physical Presence
 - Lack of Real Estate Collateral requires borrowers to pledge Available Assets
- Contact Ginny Tate for Cares and Families First Acts terms, tax and use relationship chart.

PPP-EIDL BANKRUPTCY CONCERNS

- 20% Owners Must *Certify* PPP Applications
 - What does Certify Mean?
 - Can Owner/Officer wages/draws/distributions be clawed back?
- SBA Debt Priority?
- Dischargeability?
- Cares Act Payroll Retention Tax Credits and Payroll Delayed Deposit programs adversely affect PPP and EIDL loans.

Misuse of PPP Loan Proceeds

- SBA regulations require misused funds to be repaid at once
 - Does the SBA have a priority claim?
 - Is the obligation to return misused funds dischargeable?
- Misused funds paid to owner or officers - the SBA suggests that it might pursue those funds directly.
 - Does the estate have also claim for those?
 - Does the SBA have a priority interest in estate's recovery?

Webinar Faculty

Adam Crane

Adam Crane's practice focuses primarily on areas of commercial litigation, insolvency, restructuring and financial recovery matters.

Adam joins HSM with over eight years of experience in commercial litigation, insolvency, restructuring and financial recovery. Having worked with a top Canadian law firm where he was Partner and the Chair of the Financial Recovery and Insolvency Group.

Adam's accolades include being recognised as a Benchmark Litigation Latin America Future Star (2019), Benchmark Litigation (Canada) Future Litigation Star (2018) and Benchmark Litigation (United States and Canada) 40 & Under Hot Lit (2017 and 2018).

He holds leadership positions in various international insolvency organizations including being a committee member of the Small Practice Group Committee for INSOL, committee member for the Turnaround Management Association NextGen Communications Committee and the Special Projects Leader for the Commercial Fraud Committee of the American Bankruptcy Institute. Adam is a frequent speaker and writer on areas of interest which include recognition of cross-border proceedings, stakeholder communications in cross-border insolvency proceedings, and on cross-border asset recovery including procedures for locating/recovering evidence and assets.

Prior to his call to the bar in Nova Scotia, Adam received a Juris Doctor degree (Business Law Specialization Certificate) from the Schulich School of Law at Dalhousie University in 2010 and received a Bachelor's degree from Acadia University in 2005.

Melissa Davis

Ms. Davis concentrates on providing bankruptcy, litigation and forensic investigation services to debtors, creditors, receivers, assignees, bankruptcy trustees, examiners and liquidating trusts. Her practice also includes forensic accounting, fraud investigations, litigation support and family law matters.

Ms. Davis has served as a financial advisor to fiduciaries operating distressed companies in a variety of industries including mobile fueling, health insurance, real estate, hospitality, assisted living facilities/nursing homes, metal extrusion, stevedoring and waste management. Her

experience includes distressed business operations, management, preservation of collateral and asset divestiture services.

Ms. Davis has investigated fraudulent and preferential transfers, prepared defense, solvency and liquidation analyses. She has worked on asset tracing, tracing of commingled funds, provided litigation support and damage calculations services, including forensic and securities fraud investigations and corporate business conduct analysis. Ms. Davis has extensive experience in Ponzi-scheme investigations and commingled funds tracing analysis. Her forensic and fraud investigations have involved working in conjunction with the Securities and Exchange Commission (SEC), the Federal Trade Commission (FTC), the Federal Bureau of Investigation (FBI) and various United States Attorneys' offices.

Ms. Davis has testified in court and depositions and served as a Liquidating Trustee and court appointed Assignee for the Benefit of Creditors.

Michael Napoli

As a court-appointed receiver and counsel to receivers and trustees, Michael Napoli works to maximize the value of insolvent entities in order to make a fair and equitable distribution to creditors. His experience covers a variety of industries with an emphasis on life settlements. Outside of the insolvency arena, Michael protects individuals and companies facing lawsuits. He works closely with his clients to create practical, business solutions to litigation problems. Representing both plaintiffs and defendants, Michael works on a wide variety of cases including securities, commercial, and products liability matters.

Michael maintains an active pro bono practice involving, among other things, assisting parents in obtaining the return of their children under the Hague Convention on the Civil Aspects of International Child Abduction.

Virginia Tate

Virginia Tate grew up in the accounting world assisting her father in his Certified Public Accounting firm while still in high school. Ms. Tate has experience in bookkeeping, tax, forensic, audit, restructuring and fraud examination accounting methods. She also has experience in human resources and holds certifications in taxation, fraud and insolvency accounting.

Ms. Tate attended the University of Washington and studied Business Administration with an Accounting focus. Ms. Tate has planned, coordinated and hosted events at Elk Point and other facilities for more than 10 years