AMERICAN BANKRUPTCY INSTITUTE

Annual Spring Meeting

CONCURRENT SESSION

Cross-Border Recovery in Fraudulent Schemes

Hosted by the Commercial Fraud and International Committees

Michael D. Napoli, Moderator
Akerman LLP; Dallas

Kimberly K. Crabbe-Adams
Harneys; Road Town, Tortola, British Virgin Islands

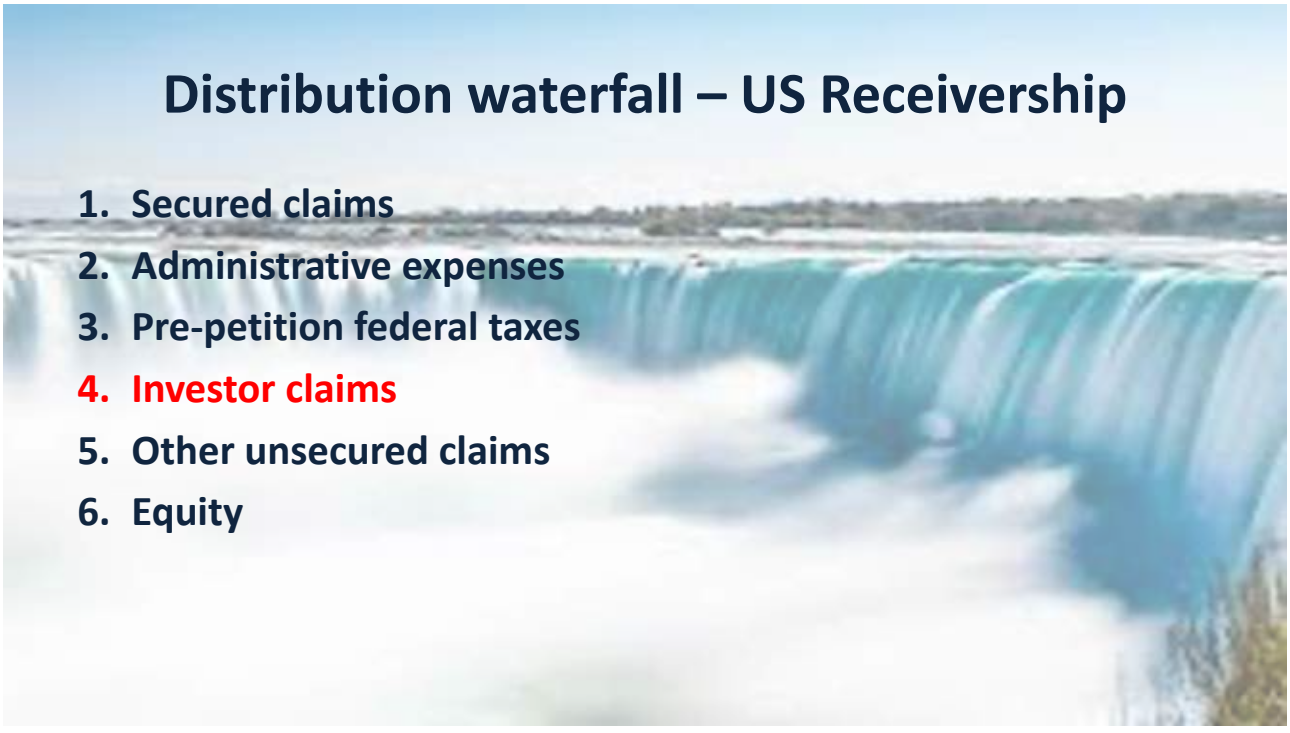
R. Craig Martin
DLA Piper; Wilmington, Del.

2024

Cross-Border Recovery in Fraudulent Schemes

Hon. Kevin J. Carey (ret.)
Kimberly K. Crabbe-Adams
R. Craig Martin
Michael D. Napoli (moderator)

Distribution waterfall – US Receivership



1. Secured claims
2. Administrative expenses
3. Pre-petition federal taxes
4. Investor claims
5. Other unsecured claims
6. Equity


Distribution waterfall -- Bankruptcy
1. Secured claims
2. Administrative expenses
3. Unsecured claims
4. Investor claims & Equity


Distribution waterfall – English Common Law
1. Secured claims (fixed charge, preferred and floating charge creditors)
2. Administrative claims (expenses of liquidation)
3. Ordinary and trade creditors
4. Statutory interest
5. Non-provable liabilities owed to trade or ordinary creditors
6. Subordinated unsecured creditors (e.g., redeeming shareholders who have not been paid)
7. Equity

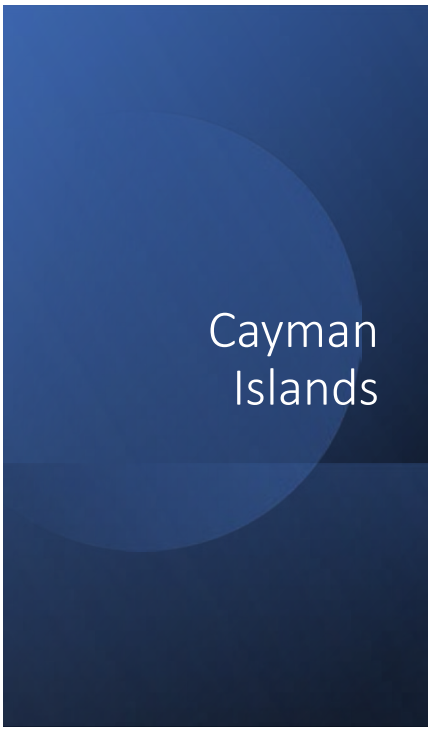
Treatment of Defrauded Investors – Commonwealth Countries

No claim against entity in liquidation

Houldsworth v. City of Glasgow Bank and Liquidators, 5 App. Cas. 317 (HL 1880)

Law is starting to change

- England: Overturned *Houldsworth* by statute (1989)
- Australia: Judicially rejected *Houldsworth* (2007)
- Bahamas: Judicially rejected *Houldsworth* (20XX)
- Cayman Islands: In process



- *In the Matter of HQP Corporation Ltd.*
  (Unreported, 7 July 2023, Doyle J)

- *In the Matter of Direct Lending Income Feeder Fund*
  (Unreported, 13 March 2024, Segal J)

US Ponzi Scheme = Fraudulent Transfers

Recovery of "profits" from investors is routine

Ponzi presumptions provide a nearly automatic win for trustees

BVI Ponzi Scheme ≠ Automatic Avoidance

- Proof of the existence of a Ponzi scheme does not automatically invalidate prior decisions of directors
- Unjust enrichment is a key ingredient to restitution
- No automatic claw-back against redeemed investors
- *Fairfield Sentry Limited (in Liquidation) v Migani and others* [2014] UKPC 9

Tension between US and Foreign liquidators

- Competing creditor interests
- Distrust of "other" proceeding
- Clashes between professionals

Resolving Tensions

FORMAL PROTOCOLS

COORDINATION BETWEEN COURTS

US FIDUCIARY SERVING AS A FIDUCIARY IN FOREIGN PROCEEDINGS

US fiduciaries overseas

Pros

- Interests will be aligned
- Some efficiencies

Cons

- Alignment is forced
- Potential of conflicts
- Contrary judicial instructions

Useful Tools in the Commonwealth

- Norwich Pharmacal Orders
- Bankers Trust Orders
- Mareva Orders

Norwich Pharmacal Orders

- Bona fide claim of fraud against a third party
- The target of the order is somehow involved, even if innocently, in the wrongdoing
- Proponent of order has a practical need for the order
- The target has relevant information
- The order is necessary and appropriate
- Full and frank disclosure

Bankers Trust Order

- Compelling evidence of fraud
- Good reason to believe that money held by target belongs to applicant
- Delay may lead to dissipation
- Target probably has information
- Documents will only be used for tracing assets

Mareva Orders

- Presuit asset freeze
- Reasonably available in Commonwealth countries; not generally available in the US

Using Chapter 15 Offensively

- Using Section 543 to force out a court-appointed receiver
- Should bankruptcy court abstain?
- What can the court appointing the receiver do?

Cross-Border Recovery in Fraudulent Schemes

Hon. Kevin J. Carey (ret.)
Kimberly K. Crabbe-Adams
R. Craig Martin
Michael D. Napoli (moderator)

I. Cross-border fraud is becoming increasingly common and more sophisticated.

A. The older and more common schemes are still out there with new twists.

(1) EB-5 Schemes – Under US immigration law, foreign nationals can obtain permanent visas to live and work in the US if they invest in a US based company and create a certain number of jobs. The exact amount of the required investment and which jobs count varies depending on the nature of the investment. These sorts of schemes are not part of this presentation because, by definition, all of the economic activity and the entities involved are US based even though the investors are foreign.

(2) Variations of the "Nigerian prince scam"

(3) Romance scams are on the rise. Due to the Internet, scammers are quite often overseas but appear to be local. Particular problem preying on the elderly. Romance Scams — FBI

B. Growing use of Caribbean nations for investment purposes. Investment companies formed overseas to facilitate investments in the US or investments by US citizens. Some of these have turned out to be frauds. Examples of this include Direct Lending Income Fund, Fairfield Sentry and Stanford.

C. As globalization increases, fraudulent companies are now operating in numerous countries, e.g., FTX

II. There are significant differences in the treatment of defrauded investors within US law and between US law and that of many Commonwealth countries such as the Cayman Islands and the British Virgin Islands.

A. There are manifest differences in the recovery allotted to defrauded investors between (i) federal equity receiverships arising out of regulatory enforcement actions by agencies such as the Securities and Exchange Commission and (ii) bankruptcy proceedings.

(1) In federal equity receiverships, defrauded investors are a favored class.

(a) As an "equitable matter in receivership proceedings arising out of a securities fraud, the class of fraud victims takes priority over the class of general creditors with respect to proceeds traceable to the fraud." *U.S. Commodity Futures Trading Comm'n v. PrivateFX Global One*, 778 F. Supp. 2d 775, 786 (S.D. Tex. 2011). The equitable doctrine of constructive trusts gives "the party injured by the unlawful diversion a priority of right over the other creditors of the possessor." III Clark on Receivers § 662.1 at 1174 (Anderson 3rd ed. 1959) (quoting authorities).

(b) Receivership distributions are agnostic to the form of the investment – equity versus debt. All investors are deemed to have a rescission claim.

(c) Even though the Federal Priority Statute (31 U.S.C. § 3713) requires that the IRS be paid before any other creditor, the IRS routinely agrees to cede its distribution priority in favor of defrauded investors. *See* Department of Justice, Tax Division - Directive Number 137.

(d) However, defrauded investors are limited to recovering their net loss measured on a strict money-in/money-out basis which does not distinguish between nominal interest payments and nominal principal payments. *See, e.g., SEC v. Forex Asset Mgmt. LLC*, 242 F.3d 325, 331 (5th Cir. 2001); *United States v. Durham,* 86 F.3d 70, 72 (5th Cir. 1996). This is accomplished either by netting the investor's claim or by employing a rising tide methodology. Under the rising tide methodology, pre-petition payments are considered part of the distribution and are subtracted from the amount to which the investor would have been entitled had he not received a payment. In effect, this means that investors who received payments from the defendant do not receiver distributions until other investors receive the same percentage recovery. So an investor who recovered 30% of his investment pre-petition would receive nothing until all other investors received distributions equal to 30% of their investments. The rising tide methodology is the preferred method where there is any significant history of payments to investors, e.g., Ponzi scheme of any length. *SEC v. Huber*, 702 F.3d 903 (7th Cir. 2012).

(2) In bankruptcy, defrauded investors are a disfavored class

(a) Under bankruptcy law, fraud claims arising out of the sale of a security are subordinated. 11 U.S.C. § 510(b). Courts have tended to apply section 510(b) strictly. As the Tenth Circuit has noted, § 510(b)'s "arising from" language has been "universally held" to cover "claims alleging fraud in the inducement to purchase or sell [a covered] security." *In re Del Biaggio*, 834 F.3d 1003, 1010 (9th Cir. 2016)(quoting *In re Geneva Steel Co.*, 281 F.3d 1173, 1174 (10th Cir. 2002)). Arguments such as constructive trusts that support prioritizing investor claims outside of bankruptcy do not work in bankruptcy. *In re Stylesite Mktg., Inc.*, 253 B.R. 503, 510 (Bankr. S.D.N.Y. 2000) (holding that mandatory subordination under section 510(b) bars constructive trusts).

(b) The form of the investment matters in bankruptcy. Under section 510(b), the investor's recission claim "shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security." 11 U.S.C. § 510(b). Thus, if the investor's claim is characterized as a claim arising out of debt, the restitution claim will be subordinated to unsecured creditors but above equity. But, if it is characterized as a claims arising out of equity, it will have the same priority as equity. *Id.*

(c) The subordination can be particularly problematic in the context of a Ponzi scheme. As a general matter, investments in Ponzi schemes (regardless of characterization as debt or equity) are generally considered to be illegal and, thus, unenforceable. *Donnell v. Kowell*, 533 F.3d 762, 772 (9th Cir. 2008)(investment contracts to invest in Ponzi scheme were void); *also Sender v. Simon*, 84 F.3d 1299, 1307 (10th Cir. 1996)(holding that contract to invest in Ponzi scheme was illegal and not enforceable); *Janvey v. Brown*, 767 F.3d 430, 441-42 (5th Cir. 2014)(CDs issued by Stanford Bank were illegal and, thus, not enforceable in equity); *Cf Kelley v. Boosalis*, 974 F.3d 884, 893 (8th Cir. 2020) (holding that contracts to invest in a Ponzi scheme were illegal but could be enforced by innocent participants under Minnesota law). As a result, Ponzi victims can be left with nothing but a rescission claim, which puts their recovery below that of general creditors.

Investments in Ponzi schemes regardless of whether they are characterized as debt or equity are considered to be

securities. Thus, they will inevitably be subject to section 510(b).

(d) The rising tide methodology may not be allowed. *See In re the Vaughn Co., Realtors*, 543 B.R. 325, 337-340 (Bankr. D.N.M. 2015)(holding that the rising tide methodology violates section 1123(a)(4) requirement of the same treatment within a class but acknowledging that other bankruptcy courts have allowed rising tide).

(e) An important caveat. Not all fraud schemes involve the sale of a security. For example, *FTC v. Simple Health Plans, LLC*, 58 F.4th 1322 (11th Cir. 2023) involved the fraudulent sale of health insurance contracts, i.e., victims were told that they were purchasing health insurance when they were actually buying prescription discount cards. Where there is no sale of a security, then section 510(b) should not apply.

(3) Ultimately, the distinction turns on the differences between the proceedings. A receivership imposed in a regulatory proceeding is a pre-judgment remedy intended to preserve the restitution claim. *SEC. v. Infinity Grp. Co.*, 27 F. Supp. 2d 559, 561 (E.D. Pa. 1998)(holding that the court could impose a receivership "so that the victims can obtain complete relief"). Whereas, a bankruptcy is intended to liquidate or reorganize an entity for the benefit of all creditors.

(4) But, this distinction may not have tremendous practical impact as Ponzi schemes being generally devoid of any legitimate business operations tend not to have many ordinary creditors who aren't susceptible to equitable subordination or disallowance.

B. There are also significant differences between US law and the law of Commonwealth countries such as the British Virgin Islands or the Cayman Islands.

(1) Standard waterfall in English law as generally adopted in Commonwealth jurisdictions:

- Secured claims (fixed charge, preferred and floating charge creditors)
- Administrative claims (expenses of liquidation)
- Ordinary and trade creditors
- Statutory interest
- Non-provable liabilities owed to trade or ordinary creditors

- Subordinated unsecured creditors (e.g., redeeming shareholders who have not been paid)
- Equity

(2) Traditionally, English common law did not allow defrauded investors to assert rescission claims post-liquidation.

(a) *Houldsworth v. City of Glasgow Bank and Liquidators*, 5 App. Cas. 317 (HL 1880) – City of Glasgow Bank was an unlimited liability company that operated a large bank. Until its collapse in 1877, Glasgow Bank was considered one of the premier financial institutions of its time. Houldsworth invested £4,000 in the bank based on fraudulent representations and financial statements presented by the bank.

Shortly after Houldsworth invested, the bank failed and went into liquidation. Because the bank was an unlimited liability company, Houldsworth not only lost his investment but was liable for the bank's debts, which he paid for a time. Houldsworth sued the bank's liquidator to recover his lost investment and the portion of the bank's debt for which he was liable on the grounds that his purchase of the bank's stock had been procured by fraud.

The House of Lords ultimately ruled against Houldsworth holding that a shareholder cannot sue a corporation for fraud unless he first rescinds the purchase contract and renounces the shares. But, once a corporation goes into liquidation, contracts with the company can no longer be rescinded. So, having failed to rescind his share purchase before liquidation, Houldsworth was barred from seeking damages for the misrepresentation after liquidation. [Discussion of case taken from M. Nehme and M. Hyland, *Houldsworth: An Obsolete Piece in the Legislative Puzzle*, 12 UWSLR 124, 126-27 (2008)]

(b) In England, *Houldsworth* was overruled by a statutory change in 1989. *See* § 111A of the Companies Act 1985 as amended by § 131(1) of the Companies Act 1989 now codified at § 655 of the Companies Act 2006 of England.

(3) Why do we care about a 140-year old case from England?

(a) It is still good law in many countries of the Commonwealth. Although that is starting to change.

(b) Australia: *Sons of Gwalia Ltd v Margaretic*, (2007) 231 CLR 160. Court held that defrauded shareholders could obtain rescission damages in liquidation even if they had not rescinded pre-liquidation. In addition, claims would have the same priority as ordinary unsecured claims. The priority ruling was later changed by statute.

(c) Bahamas:

(d) Cayman Islands:

In the Matter of HQP Corporation Limited (In Official Liquidation) (Unreported, 7 July 2023, Doyle J). Justice Doyle found that *Houldsworth* did not apply in Cayman law. Therefore, defrauded investors could seek rescission damages in liquidation and their claims would be *pari passu* with ordinary creditors.

In the Matter of Direct Lending Income Feeder Fund (Unreported, 13 March 2024, Segal J). Justice Segal found that *Houldsworth* partially applied in Cayman law. Defrauded investors could seek rescission damages in liquidation but their claims would fall below ordinary creditors and be *pari passu* with redemption creditors.

HQP is on appeal with oral argument scheduled in May 2024.

(4) Assuming that rescission claimants can seek damages in liquidation, priority remains uncertain.

C. Availability of claw-back claims against "winning" investors varies between US and Commonwealth jurisdictions

(1) Claw-back actions against "net winners" are widely available in the United States

(a) Remedy available under state fraudulent transfer law (Uniform Voidable Transfers Act) and Bankruptcy Code (11 USC § 548).

(b) Ponzi presumption aids in recovery from "net winners."

i. There are actually three related presumptions

First, transfers in furtherance of a Ponzi scheme are presumed to be made with an actual intent to hinder, delay or defraud a creditor.

Second, the operator of a Ponzi scheme (the debtor) is insolvent as a matter of law.

Third, the payments of false profits to investors or commissions to sales agents are transfers without the receipt of equivalent value.

ii. Widely accepted in federal court but has been questioned in a few state courts

Federal: *Klein v. Cornelius,* 786 F.3d 1310, 1320 (10th Cir. 2015) ("[B]ecause Ponzi schemes are insolvent by definition, we presume that transfers from such entities involve actual intent to defraud."); *Janvey v. Brown,* 767 F.3d 430, 439 (5th Cir. 2014) (under TUFTA, "existence of the Ponzi scheme establishes fraudulent intent"); *Wiand v. Lee,* 753 F.3d 1194, 1201 (11th Cir. 2014) ("proof that a transfer was made in furtherance of a Ponzi scheme establishes actual intent to defraud" under Florida Uniform Fraudulent Transfer Act); *Wing v. Dockstader,* 482 Fed. Appx. 361, 363 (10th Cir. 2012) ("Under [UFTA], once it is established that a debtor acted as a Ponzi scheme, all transfers by that entity are presumed fraudulent."); *Donell v. Kowell,* 533 F.3d 762, 777 (9th Cir. 2008) ("The mere existence of a Ponzi scheme is sufficient to establish actual intent to defraud.")

State: *Finn v. Alliance Bank*, 860 N.W.2d 638 (Minn. 2015)(expressly rejecting application of doctrine to allged scheme involving both real and fraudulent transactions); *Janvey v. Golf Channel, Inc.*, 487 S.W.3d 560, 567 n.27 (Tex. 2016) ("Though we need not consider the validity *vel non* of the Ponzi-scheme presumptions, we note that TUFTA provides only one express presumption: 'A debtor who is generally not paying the debtor's debts as they become due is

presumed to be insolvent.' Tex. Bus. & Com. Code § 24.003(b).").

(2) In the British Virgin Islands, an office holder will have difficulty clawing back redemption payments even if they were made in a Ponzi Scheme, if that office holder is unable to prove the unjust enrichment of the redeemed shareholder.

Fairfield Sentry Limited (in Liquidation) v Migani and others [2014] UKPC 9 – Fairfield Sentry Limited (the ***Fund***) was a company incorporated in the British Virgin Islands, and which from 1997 to 2008 operated as the largest feeder fund which placed money with BLMIS for investment. Over that period, approximately 95% of its assets was placed with BLMIS. These assets were estimated in the region of US$7.2 billion.

Once the frauds committed by Madoff came to light the Fund was shortly thereafter ordered to be wound up by the BVI court.

The liquidators of the Fund subsequently brought claw back claims in the BVI seeking the recovery of the redemption monies paid to redeemed US investors. By the time of the claw-back claims, the redemption payments were known to have been made on a mistaken premise, i.e. the miscalculation of the NAV.

On final appeal to the Privy Council, there were several questions for the Board to resolve. One was the necessity of proving unjust enrichment in a claim for restitution.

Finding against the liquidators and quoting Lord Hope in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349 at 408B, the Privy Council reiterated that '[t]he payee of money "cannot be said to have been unjustly enriched if he was entitled to receive the sum paid to him".'

On this premise, the Court reasoned that the Fund's claim to recover the redemption payments depended on whether it was bound by the redemption terms to make the payments which it did make. This in turn depended on whether the effect of those terms was that the Fund was obliged upon a redemption to pay (i) the true NAV per share, ascertained in the light of information which subsequently became available about Madoff's frauds, or

(ii) the NAV per share which was determined by the Fund's directors at the time of redemption.

The Privy Council reasoned that if (ii) was correct, then the shares having been surrendered in exchange for the amount properly due under the Fund's Articles of Association, (i.e. the redemption payments) would be irrecoverable.

The Privy Council highlighted that the Fund's Articles of Association in this case clearly envisaged, that the subscription price and the redemption price for shares were to be definitively ascertained at the time of the subscription or redemption. As such the NAV could only be the one determined by the Fund's directors at the time, whether or not the determination was correctly carried out in accordance with the Fund's Articles.

This was one of the four grounds on which the Liquidators failed in in the BVI to claw-back the claims against the redeemed investors.

The liquidators had filed claims in multiple jurisdictions, including the US. The US court stayed its claims pending the outcome of the Privy Council proceedings.

III. Interaction between US and foreign liquidators – Legal and practical considerations

A. Tensions and differences of opinion between US and foreign liquidators

(1) FTX is an example. There was a US bankruptcy filed by FTX as well as a Bahamian liquidation proceeding. To simplify, the liquidator in the Bahamas had claimed assets that the US debtor in possession had also claimed. These competing claims resulted in litigation between the two estates which was resolved by settlement late last year.

(2) Causes of tension

(a) Competing creditor interests

iii. Differences in the law between jurisdictions can lead to differences in the treatment of creditors. As a result, creditors may prefer one jurisdiction over the other.

iv. Entities in different jurisdictions may have different creditors and different assets. Creditors in jurisdictions with more assets and fewer claims will wish to lock in that situation leading to disputes with liquidation proceedings in other jurisdictions.

(b) Distrust of parties in control of other liquidation proceeding

i. Debtor in possession may not be trusted by creditors in other jurisdictions even if debtor's management has changed.

ii. Distrust of proceedings in other countries.

(c) Clashes between leading professionals

B. Methods of lessening or ending tensions

(1) Enter into a formal protocol

(a) Protocol is a formal agreement between the fiduciaries of different estates as to the relationship between the estates. It can cover a wide variety of topics ranging from allocation of assets to treatment of certain creditors.

(b) Protocols must be approved by all courts involved.

(c) In effect, a protocol is a settlement agreement between fiduciaries.

(2) Coordination between judges

(a) Generally ad hoc subject to the court's discretion and in consultation with the parties – can include joint hearings or direct communications between courts.

(b) SD Texas General Order 2019-2 (entered January 31, 2019)

i. Authorizes courts to receive and respond to communications by sending court documents (e.g., orders, affidavits, transcripts) or by directing counsel to do so.

ii. Authorizes two-way communication (talking or corresponding) but (a) parties are generally (but not

always) entitled to be present; (b) notice should be given; (c) discussions should be transcripts and (d) transcripts should be made available.

iii. Creates a procedure for joint hearings.

(3) US fiduciary (receiver or trustee) serve as a Joint Operating Liquidator or fiduciary in foreign proceeding.

(a) (Example) Direct Lending – Receiver appointed in the SEC enforcement proceeding was also named as the Joint Operating Liquidator in Cayman liquidation proceeding.

i. Corporate Structure:

- Direct Lending Income Fund, LP (feeder fund for US based investors) – sole investments were equity in and loans to master fund

- Direct Lending Income Feeder Fund, Ltd, a Cayman Islands exempt company (feeder fund for non-US investors) – sole investments were equity in and loans to master fund – DLIFF's directors were US based principals of DLI Capital and it was managed by another US-based DLI entity.

- DLI Capital, Inc and subsidiaries DLI Assets, LLC and DLI Assets Bravo LLC (master fund)

ii. US receivership court appointed receiver over all DLI entities foreign and domestic

iii. US receiver caused Cayman fund – DLIFF – to go into voluntary liquidation naming himself and a Cayman liquidation specialist as Joint Operating Liquidators.

(b) Does having a single fiduciary serve in two related proceedings make sense – it seems to have worked out in Direct Lending but that may have been an exceptional case. Direct Lending may have had certain characteristics that made the dual fiduciary feasible.

i. Pros:

- Certainly aligned the interests of the two estates
- Likely saved time and cost – clearly some efficiencies

ii. Cons:

- Single fiduciary could find himself or herself trapped between competing directions from two different courts
- Potential conflicts of interest between estates

IV. Useful tools in Commonwealth Jurisdictions

A. Norwich Pharmacal Order

(1) From another English case: *Norwich Pharmacal Co. v. Customs and Excise Commissioners*, [1974] A.C. 133.

(2) Can be used to obtain documents or information about the identify of a fraudster or to trace assets.

(3) Requirements vary slightly from jurisdiction to jurisdiction but generally the party seeking the order must demonstrate

(a) That there is a bona fide claim of fraud or other wrongdoing against a third party

(b) That the person against whom the order is sought is somehow involved, even if innocently, in the alleged wrongdoing

i. In the context of an investment fund, the target can include the fund administrator who should have the funds books and records.

ii. Other potential targets are banks, internet service providers and cloud vendors such as Salesforce or Intuit serving the fraudster

(c) That the person seeking the order has a practical need for the order

(d) That the person against whom the order is sought has relevant documents or information

(e) That the order is necessary and appropriate

(4) Party seeking the order must make "full and frank disclosure" – must inform the court of not only the arguments and evidence in support of the motion but also arguments and evidence against the motion.

(5) Can include an order requiring the target not to disclose the existence of the order – a "gagging order"

(6) Norwich Pharmacal orders are not generally available in the US.

(a) Federal Rule of Civil Procedure 27 allows depositions before suit but must demonstrate that there is a risk that the testimony will be lost if not immediately taken.

(b) But see Texas Rule of Civil Procedure 202 – allows pre-suit discovery to investigate a potential claim or suit.

i. Available to both plaintiffs and defendants

ii. All the party needs to show is either that (i) allowing the requested deposition will prevent a failure or delay of justice in an anticipated suit or (ii) the benefit of allowing the petition to investigate a potential claim outweighs the cost of the procedure.

iii. But, the Texas court must have both personal jurisdiction over the anticipated defendant and subject-matter jurisdiction over the anticipated claim.

B. Bankers Trust orders – how do these differ from Norwich Pharmacal orders?

(1) The court's equitable jurisdiction to grant relief to enable funds to be traced and as set out in Banker's Trust v Shapira [1980] 1 WLR 1274

(2) Where a person has become involved (albeit innocently) in the disposal of particular assets to which the applicant is making a proprietary claim, and is likely to have information about what has happened to these assets, the court is prepared to grant an interlocutory order requiring that person to disclose all information which will assist in discovering the location of assets. In Banker's Trust itself the order was granted in relation to bank

records and was ancillary to the applicant's right to trace the missing monies. The applicant had no right against the bank itself.

(3) An applicant seeking Bankers Trust relief must satisfy the court that (Banker's Trust at [19]):

(a) there is compelling evidence that the applicant was defrauded or otherwise wrongfully deprived of his money. As noted by Waller LJ in Banker's Trust the order should not be made lightly. In that case there was "very strong evidence" of fraud justifying the grant of relief. It is this evidence of fraud which disentitles the wrongdoer from relying on the confidential relationship between himself and his bank;

(b) there is good reason to believe that the money now or previously held by the discovery defendant belongs to the applicant;

(c) delay may lead to dissipation of the funds. If steps are going to be taken, it is important that they should be taken at the earliest possible moment (per Lord Waller in Banker's Trust);

(d) there is a real prospect that the information or documents sought may lead to the location or preservation of the assets to which the applicant is making a proprietary claim (*Arab Monetary Fund v Hashim (No 5)* [1992] 2 All ER 911 at 918, per Hoffman J); and

(e) the documents will be used only for tracing what happened to the applicant's money.

(4) Applications should, so far as possible, define the missing assets and the information sought (*Arab Monetary Fund v Hashim (No 5*)). The applicant must also provide the usual undertakings in damages and pay the respondent's costs of providing the information in compliance with the order.

(5) The court will balance the interests of the intrusion into the privacy of the respondent against the potential detriment to the applicant if the information is not provided. Once a suitable case is demonstrated courts are willing to grant wide orders. As noted by Lord Waller in Banker's Trust unless there is the fullest possible information the tracing of funds may be impossible.

C. Mareva Orders

(1) *Mareva Compania Naviera S.A. v. International Bulkcarriers S.A.* [1975], 2 Lloyd's Rep. 509 (C.A.)

(2) A *Mareva* order is a pre-suit asset freeze

(3) Reasonably easy to obtain in a Commonwealth country; generally not allowed in the US.

(a) British Virgin Islands - *Convoy Collateral Ltd v Broad Idea International Ltd* [2021] UKPC 24 – confirms that the BVI Court has jurisdiction to grant standalone freezing orders in aid of foreign proceedings. It also confirms that where the court has personal jurisdiction over a party, the court has the common law power to grant a standalone freezing injunction against that party to assist enforcement through the court's process of a prospective (or existing) foreign judgment.

V. Can disgruntled investors use a foreign insolvency proceeding coupled with Chapter 15 to unseat a receiver?

A. Chapter 15 provides the sole procedure by which a foreign insolvency proceeding can be recognized in the United States.

(1) To qualify as a foreign proceeding, the foreign representative must establish: a (1) a proceeding, (2) that is judicial or administrative, (3) collective, (4) in a foreign country, (5) conducted under law relating to insolvency, (6) under the supervision of a foreign court, and (7) for the purpose of reorganization or liquidation *In re Irish Bank Resol. Corp. Ltd.*, 538 B.R. 692, 697 (D. Del. 2015). Property can include a cause of action against someone.

(2) Must there be property in the United States?

(a) Yes. *In re Barnet*, 737 F.3d 238, 247 (2d Cir. 2013) (all eligibility requirements of § 109(a) – domicile, place of business or property in the US – apply to Chapter 15 per plain reading of Code)

(b) No. *In re Al Zawawi*, ___ F.4th ___, 2024 WL 1423871 (11th Cir. April 3, 2024)(recognizing plain language of Code but

bound by prior circuit opinion holding that foreign debtor need not qualify as a US debtor for purposes of former § 304 ancillary proceedings).

(3) Foreign proceedings can be recognized as either a foreign main or a foreign non-main proceeding.

(a) A foreign main proceeding is a proceeding pending in the country where the debtor has its center of main interests. 11 U.S.C. § 1502(4). The country in which the debtor's registered office is located is presumed to be is center of main interests. But, this presumption may be rebutted.

A foreign non-main proceeding is a foreign proceeding in a country where the debtor has an establishment, i.e., a place of operations where the debtor carries out a non-transitory economic activity. *Id*. at § 1502(5).

(b) What is the difference?

i. In a foreign main proceeding, the automatic stay applies, sales of US assets outside the ordinary course are forbidden; and the foreign representative can operate the debtor's business. 11 U.S.C. § 1520.

ii. In a foreign non-main proceeding, the court can order all of these things but they are not automatic. *Id*. at § 1521.

iii. In either case, the foreign representative has standing to sue in the United States and to intervene in any case involving the debtor. *Id.* at §§ 1523, 1524.

(c) What happens if the foreign proceeding is in a country where the debtor does not conduct non-transitory economic activity?

B. Interaction between a US based liquidation (e.g., a federal equity receivership) and a Chapter 15 proceeding.

(1) Does turnover under 11 U.S.C. § 543 apply? Notably, it is not one of the sections that is expressly made applicable under §§ 1520 or 1521.

(a) Section 543 requires custodians (including receivers) to "deliver to the trustee any property of the debtor held by or

transferred to such custodian." 11 U.S.C. § 543(b)(1). Receivership defendants, their allies or disgruntled creditors have filed bankruptcies (either voluntary or involuntary) in attempts to dislodge court-appointed receivers in fraud cases. *See In re Michael S. Starbuck, Inc*., 14 B.R. 134 (Bankr. S.D.N.Y. 1981) (abstaining from case that was administered in securities receivership)

(b) Effectively yes.

In re Atlas Shipping A/S, 404 B.R. 726, 746 (Bankr. S.D.N.Y. 2009)(holding that § 543 was inapplicable in Chapter 15, as turnover is provided for under § 1521(a) and (b)). In *Atlas*, the court noted its broad discretion under § 1521 and ordered turnover. *Also In re Lee,* 472 B.R. 156, 182 (Bankr. D. Mass. 2012) (stating that § 542 was inapplicable in Chapter 15 pursuant to § 103)

In re AJW Offshore, Ltd., 488 B.R. 551, 560–61 (Bankr. E.D.N.Y. 2013)(holding that § 543 expressly applies)

(c) Does this distinction matter? Not practically. Although it is described as mandatory and uses mandatory language, § 543 turnover is actually discretionary. 11 U.S.C. § 543(d)(1)(providing that the bankruptcy court may excuse compliance with the section). *See also* 11 U.S.C. § 543(d)(2) (providing the trustee shall excuse compliance if the receiver has been in place for 120 days).

(2) Can the bankruptcy court abstain?

(a) Abstention is governed by 11 U.S.C. § 305. It expressly authorizes bankruptcy courts to abstain if "the purposes of chapter 15 … would be best served." 11 U.S.C. § 305(a)(2).

(b) Why would the bankruptcy court abstain? Bankruptcy courts generally abstain from adjudicating cases when the following elements are met: (1) the petition was filed by a few recalcitrant creditors and most creditors oppose the bankruptcy; (2) there is a pending state insolvency proceeding; and (3) dismissal is in the best interest of the debtor and all creditors. Moreover, abstention under Bankruptcy Code § 305 is appropriate where the matter is pending in another forum. *In re Michael S. Starbuck, Inc*., 14 B.R. 134 (Bankr. S.D.N.Y. 1981) is the preeminent case is this area.

(3) Can the district court withdraw the reference?

(a) Note that the standard order appointing receivers used by most regulatory agencies enjoins all persons from filing a bankruptcy. This only works if the receiver is appointed by a federal court.

Faculty

Kimberly K. Crabbe-Adams is a member of Harneys' Litigation & Insolvency Restructuring practice in Road Town, Tortola, BVI. Her clients include insolvency practitioners, international law firms and individuals. Prior to joining Harneys permanently in the BVI, Ms. Crabbe-Adams held specialist pupillages in their Corporate and Commercial, Banking and Finance and Investment Funds and Regulatory departments. She joined her current practice in 2011 and shortly thereafter was seconded to the Hong Kong office's Litigation and Insolvency practice. Ms. Crabbe-Adams' practice includes liquidation and remuneration applications, applications for the enforcement of foreign judgments, Norwich Pharmacal disclosure applications and restoration applications. She also assists with shareholder disputes which seek unfair prejudice remedies or result in derivative claims. Ms. Crabbe-Adams is the president of the BVI Bar Association and in that capacity serves as an *ex officio* member of the Virgin Islands General Legal Council. She completed the membership certificate in international arbitration from the Chartered Institute of Arbitrators and is an ABI member. Ms. Crabbe-Adams received her B.A. in 2004 from Acadia University, her LL.B. in 2008 from Durham University and her bar vocational course in 2009 from BPP Law School.

R. Craig Martin is the managing partner of DLA Piper LLP's Wilmington, Del., office and is global co-chair of Restructuring. He has spent his legal career working on complex distressed situations. He has represented numerous parties in a variety of cases, including equity committees, committees of unsecured creditors, bank groups, indenture trustees and debtors. He has also advised purchasers of assets in bankruptcy auctions and court-approved sales and frequently provides bankruptcy-specific advice in complex mergers and acquisition situations involving distressed entities. Mr. Martin has appeared in the bankruptcy courts all across the U.S., but his work frequently focuses on cross-border situations. He has acted as counsel in cases in Canada, Germany, Ireland, Hong Kong, Spain, Bermuda, the Dominican Republic, Africa, the U.K. and Argentina. He has also acted as first-chair litigation counsel in a number of cases involving terms of bond indentures, such as x-clauses, permitted indebtedness clauses and other covenants. Mr. Martin co-authored ABI's *Chapter 15 for Foreign Debtors* and is admitted to practice in Delaware, the District of Columbia, New York, Pennsylvania and Texas. He received his B.A. in history from Texas Christian University, his M.Sc. from the University of Edinburgh and his J.D. *cum laude* from the University of Houston Law Center.

Michael D. Napoli is a Fraud and Recovery partner with Akerman LLP in Dallas. As a court-appointed receiver and counsel to receivers and trustees, he works to maximize the value of insolvent entities inorder to make a fair and equitable distribution to creditors. Mr. Napoli's experience covers a variety of industries with an emphasis on life settlements. Outside of the insolvency arena, he protects individuals and companies facing lawsuits. Representing both plaintiffs and defendants, Mr. Napoli works on a wide variety of cases, including securities, commercial and product-liability matters. He also 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. Mr. Napoli is Newsletter Editor of ABI's Commercial Fraud Committee and a member of the Dallas Bar Association and the National Association of Federal Equity Receivers. He received his B.A. with honors in 1988 from Baylor University and his J.D. in 1991 with high honors from the University of Texas School of Law, where he served on the Texas Law Review and was admitted to the Order of the Coif.