

## **When Innocent Investors Become Losers – Litigating the Ponzi Scheme Case**

**By: Teresa Gillis, Esq., Shustak & Partners, P.C., New York and California**

It has become all too common that an innocent investor gets bilked of his or her retirement or investment funds by handing it over to a promoter who promises steady high returns, but in reality is committing serial fraud using other people's money. In a typical scenario, the Ponzi scheme operator takes in hundreds of thousands or millions of dollars over a period of years before the scheme is exposed and the company put into bankruptcy or receivership. At that point, many investors end up with massive losses, since there is usually not enough money to satisfy all claims. Every year across the country, receivers and bankruptcy trustees are appointed to marshal the assets or what remains of assets in such investment fraud schemes.

A lesser known phenomenon occurs when an innocent investor who actually made money from the Ponzi scheme before it is exposed finds himself or herself being sued by the receiver or bankruptcy trustee after the fraud comes to light. Such "winners" have been sued with increasing frequency both in bankruptcy cases and receiverships in recent years. These suits will likely persist, as many courts have held that "profits" or interest should be returned to the receivership or bankruptcy estate in order to be redistributed to all of the investors.

Typically, these cases are brought on the grounds that the transfers of funds from an insolvent entity were fraudulent conveyances. This theory can permit a receiver to draw back funds that were paid out of the companies by showing that the payments diminished the assets available to satisfy the creditors of an insolvent entity.

A receiver or trustee has considerable advantages in bringing such claims against investors, even innocent investors who had no idea they were investing in a Ponzi scheme.

- The fact that there was a Ponzi scheme usually meets the first requirement of state law regarding fraudulent conveyances -- that the transfer that diminishes the assets available to satisfy the creditors of an insolvent entity. By definition, this is how Ponzi schemes operate.
- While in a normal case, the person challenging a fraudulent conveyance must show that the transferor had intent to defraud, in cases involving Ponzi schemes, fraudulent intent on the part of the transferor may be inferred because of the scheme.
- While the fraudulent conveyance statutes provide that a payment from a Ponzi scheme will not be considered a fraudulent transfer if taken in good faith and "for reasonably equivalent value," the innocent investor has the burden of proving his own good faith. In addition, both prongs of this test must be met.
- Some courts have held the innocent investor to a fairly rigorous standard of objective good faith. In such cases, the investor who received back funds must show that he did not know, *and* had no reason to know, of the fraudulent scheme.

The "winner" investor who can show good faith may be entitled to keep at least the bulk of the payments he or she received, however. The investor must try to demonstrate that he or she

gave the scheme “reasonably equivalent value” for the payments. Many courts have held that the innocent investor in a Ponzi scheme has given value only to the extent that repayment has reduced the investor’s claim for restitution of the amounts he paid in to the scheme. Other courts, however, have held that investors could retain some level of profit or interest and that the bankruptcy or receivership court is not a proper forum for redistributing such profits.

In addition, the innocent investor may have various defenses based on the statutes of limitations and other legal doctrines as well as set-offs and other forms of recoupment. Much depends on the specific facts of the investor’s particular situation, and how the court views the relative equities between the investor, the receiver and the other claimant