ANALYSIS — Ponzi Schemes and Controversial Clawback Claims Against Investors by Win Gault & Spencer Ritchie

Win Gault and Spencer Ritchie provided analysis on the recent Ponzi scheme in Mississippi, read their article in the *Mississippi Business Journal* here.

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Many have called Madison Timber Properties, LLC the largest Ponzi scheme in Mississippi history. The scheme involved more than one hundred million dollars in investments and hundreds of investors spanning many years. The scheme has attracted the attention of national media outlets including the New York Times, the Washington Post, and Forbes.

Now, in the wake of the scheme����collapse, the recent guilty plea is only the beginning. Many questions remain. Among them, what happens to the investors in the scheme?

In a nutshell, a Ponzi scheme is a financial arrangement where the Ponzi operator, without a legitimate underlying business, makes payments to past investors with funds collected from new investors. While Ponzi schemes can last for years, all eventually collapse, usually when the operator is unable to recruit enough new investors to fund the withdrawal requests of existing investors.

A Ponzi scheme's collapse almost invariably leads to a bankruptcy, receivership, or some other formal dissolution and liquidation proceedings. In these proceedings, a trustee or receiver is charged with maximizing funds to pay creditors and scammed investors.

Among the methods trustees or receivers have used to recover assets are claims against investors who received returns from the scheme. This controversial method of recovery is often referred to as a clawback action. Clawbacks have been used in recent high-profiled Ponzi scheme proceedings such as Madoff, Stanford, Bayou and Goldberg.

While it seems counterintuitive and inequitable to assert claims against any defrauded investor, the theory underlying clawback actions is that money received by those investors came from other defrauded investors, and all investors should be on equal ground. The asserted legal basis for such claims rests in both federal bankruptcy law and state fraudulent transfer laws.

The use and breadth of clawbacks are usually hotly contested, and courts have reached different results. A recent example of how a trustee or receiver used clawback claims against investors who received money from a Ponzi scheme is the Michael Goldberg case that occurred in Connecticut. In total, the Goldberg scheme had over 350 investors who invested over $100 million. After the scheme collapsed, Goldberg filed for bankruptcy and was later sentenced to a 10-year prison term. Total loss to investors was estimated at $30 million.

The bankruptcy trustee in the Goldberg case filed multiple clawback actions against investors in the Ponzi scheme who had received money from it. The trustee sought to recover not only profits earned from the investments, but also those investors' returned principal. The investors contested the trustee's authority to recover amounts they invested as principal, asserting a good-faith investor defense available under federal bankruptcy law.

The Goldberg bankruptcy judge ruled in favor of the trustee's efforts to recover both the profits from the scheme and the principal invested in the scheme. Other judges have refused to allow a receiver or trustee's clawback power to extend to principal.

It is too early in the wake of the Madison Timber Properties, LLC Ponzi scheme collapse to predict how events will continue to unfold. It is, however, safe to predict one thing. If recent history with the Madoff, Stanford, Bayou, Goldberg and other Ponzi proceedings is any indication, expect investors to clash with the trustee or receiver over any clawback efforts.

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