# Using Receiverships to Investigate and Combat Fraud

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**Abstract**

In this article, Joe Wielebinski and Matthias Kleinsasser of Winstead PC provide an overview of U.S. receivership law and discuss how this equitable remedy may be used to combat fraud alone, or in concert with other creditor remedies. The article lays out the basics of what a receivership is and what legal tools are available to a receiver charged with administering a receivership estate when fraudulent conduct is at issue. The article further discusses practical considerations for persons who suspect (but perhaps cannot confirm) they have been the victims of fraud and who wish to seek appointment of a receiver.

## 1. Introduction

Appointment of a receiver originated centuries ago in English courts of chancery under principles of equity. Broadly speaking, a receivership is an equitable remedy derived from common law under which a court appoints a person (the receiver) as an officer of the court to manage and protect property (the *res* or receivership estate, which often consists of a corporate entity and its assets), generally because the property is threatened by dissipation or diminution in value.[1] A receiver is usually granted extensive powers by the appointing court to manage assets, file claims, recover transferred property, and take other actions designed to preserve the receivership estate. For this reason, the appointment of a receiver is a flexible remedy that can be tailored to address specific circumstances. Since the appointment of a receiver usually results in displacing an entity's governing persons, however, courts generally require significant proof of fraudulent conduct, or, at a minimum, that an entity's or asset's value is seriously threatened, to grant this relief.

[1] The potential scope of the *res* is very broad. When a business entity is in receivership, the *res* will often include accounts receivable, real and personal property, causes of action, and intellectual property—in short, the entirety of the business's assets.

## 2. Basics of U.S. Federal and State Receiverships

- **What is a receivership?**

Receiverships are available under U.S. federal and state law, although the availability of the remedy, and the factors required to be satisfied to appoint a receiver, vary between U.S. jurisdictions.[2] For example, most U.S. jurisdictions permit a receiver to be appointed for fraudulent conduct on the part of the governing persons, particularly if those persons have fraudulently transferred assets or taken other actions that threaten the rights of creditors or equityholders.[3] Appointment of a receiver is also a remedy commonly sought and obtained by government regulators when fraudulent conduct is suspected and/or the interests of investors are threatened—e.g., in proceedings brought by the U.S. Securities & Exchange Commission.[4] The existence of fraud is generally not a requirement to appoint a receiver. When the entity is insolvent or in danger of insolvency and the business's assets are threatened by a serious decline in value that would severely prejudice creditors, a court will often appoint a receiver regardless of whether fraud is suspected.[5] Some U.S. jurisdictions have also enacted statutes allowing a receiver to be appointed over particular types of property, such as commercial real property.[6] Moreover, the relevant statutes or the common law of many jurisdictions permits a receiver to be appointed for any reason justified by the rules of equity, thereby giving courts broad discretion in applying this equitable remedy.[7] In addition, loan documents and other contracts frequently provide one party with the right to obtain the appointment of a receiver in its sole discretion, though courts are split as to whether such a contractual provision is enforceable.[8]

[2] *See, e.g.*, Fed. R. Civ. P. 66 (stating that an action in federal court in which the appointment of a receiver is sought is governed by the Federal Rules of Civil Procedure); *Brill v. Harrington Invs. V. Vernon Savs. & Loan Ass'n*, 787 F. Supp. 250, 253 (D.D.C. 1992) (listing several factors to be considered in appointing a receiver, such as fraudulent conduct on the defendant's part and imminent danger of property being lost, concealed, or diminished in value).

[3] *See, e.g.*, Tex. Civ. Prac. & Rem. Code §64.001(a)(1) (permitting appointment of a receiver in an action by a vendor to vacate a fraudulent purchase of property); *Brill*, 787 F. Supp. at 253 (listing fraudulent conduct on the defendant's part as a factor to be considered in appointing a receiver).

[4] *See, e.g.*, *Securities and Exchange Commission v. Stanford International Bank, Ltd., et al.*, 3-09CV0298-N, in the U.S. District Court for the Northern District of Texas, Dallas Division ("Stanford Receivership"), filings available at http://stanfordfinancialreceivership.com/.

[5] *See, e.g.*, Tex. Civ. Prac. & Rem. Code § 64.001(a) (permitting a Texas court to appoint a receiver in multiple situations, including over an insolvent corporation or over a corporation facing imminent danger of insolvency).

[6] *See, e.g.*, Maryland Commercial Receivership Act, codified at Title 24, 2019 Maryland Code, available at https://law.justia.com/codes/maryland/2019/commercial-law/title-24/.

[7] *See, e.g.*, Tex. Civ. Prac. & Rem. Code § 64.001(a)(6) (allowing a receiver to be appointed for any reason justified by rules of equity).

[8] *See, e.g.*, *LNV Corp. v. Harrison Fam. Bus., LLC*, 132 F. Supp. 3d 683, 690-91 (D. Md. 2015) (reviewing split of authority over whether a receiver may be appointed under a contract).

The breadth of a receiver's potential powers is perhaps the most significant aspect of this equitable remedy. The receiver's powers are typically outlined in the court's order appointing the receiver, meaning that courts frequently can tailor the scope of the receiver's authority to the circumstances of the case. In general, most courts appointing a receiver tend to grant the receiver extensive powers unless the receiver's powers are circumscribed by statute (e.g., because the receiver is appointed under a statute authorizing the appointment only for a specific purpose, such as foreclosing a lender's lien on real property). This could include the power to sell assets, commence litigation and/or initiate a bankruptcy proceeding, often without additional approval of the appointing court. [9] For most purposes, the receiver stands in the shoes of the entity in receivership and may act to protect the interests of any parties with an interest in the entity, such as creditors and shareholders. [10] Under the law of most jurisdictions, the receiver generally has authority to sell property or take other actions with respect to a business that could have been taken by the entity's management, so long as those actions are authorized by the court order appointing a receiver. For example, receivers are regularly authorized to marshal assets, collect rents, pursue claims belonging to the entity, and review and pay creditors' claims. Usually, an order appointing a receivership will prohibit creditors of the receivership estate and other third parties from taking action against the receivership estate outside of the court-sanctioned claims submission process.[11] In doing so, the court effectively streamlines the process of liquidating or rehabilitating the receivership estate and ensures that similarly situated parties are treated fairly. Of course, the order is limited by the court's jurisdiction, and enforcement of the order against third parties may require the intervention of foreign courts.

Typically, the receiver must execute an oath that he/she will perform their duties in good faith and must provide a receivership bond in an amount set by the court as security should the receiver fail to perform his/her duties in good faith. [12] Receivers are deemed fiduciaries in most jurisdictions and must avoid engaging in self-dealing

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[9] *See, e.g.*, Tex. Civ. Prac. & Rem. Code §§ 64.031-64.034 (listing receiver's power to bring lawsuits, take possession of property, and take similar actions).

[10] *See, e.g.*, *Reid v. United States*, 148 Fed. Cl. 503, 523 (2020) (receiver "steps into the shoes" of the entity in receivership and owes fiduciary duties to creditors). Although the receiver will act to benefit all stakeholders, most receiverships pay creditors before providing a return to equity, consistent with good corporate practice and U.S. bankruptcy law. In large receiverships with assets having value above the secured creditors' debt, creditors are generally provided with notice of a bar date by which they must submit their claims. Claims that are timely filed and allowed are then paid pro rata from the receivership estate under an established priority scheme. If assets have been fraudulently transferred (such as in a Ponzi scheme) or otherwise need to be recovered, the claims administration process may take years to complete while fraudulent transfer litigation is ongoing.

[11] *See, e.g.*, Amended Receivership Order, *Securities and Exchange Commission v. Stanford International Bank, Ltd., et al.*, 3-09CV0298-N, in the U.S. District Court for the Northern District of Texas, Dallas Division ("Stanford Receivership"), *available at* Amended_Order_Appointing_Receiver.pdf (stanfordfinancialreceivership.com) (prohibiting parties from enforcing liens, seizing assets, pursuing claims, and taking other actions against the Stanford International Bank receivership estate). (Accessed October 11, 2021).

[12] *See, e.g.*, Tex. Civ. Prac. & Rem. Code §§ 64.022-64.023.

or other actions that place the receiver's own interests above those of stakeholders in the receivership estate, such as creditors and equityholders.

Once the receiver has been appointed and has provided the oath and bond, the receiver will usually begin evaluating the financial situation of the receivership estate by reviewing assets and liabilities. If fraud is suspected, the receiver will investigate whether fraudulent transfers or other improper dissipation of assets has occurred. Receivers are often required to provide periodic reports and/or accountings to the court and are almost always required to file a final accounting once the receivership estate has been fully administered (i.e., all claims have been paid or all receivership property has been liquidated). Once the estate has been administered, the court will enter an order discharging the receiver.

### 3. How Can a Receivership Uncover Fraudulent Conduct?

A party seeking appointment of a receiver must do so by filing an application with a court of appropriate jurisdiction (or, where allowed, by making a request for receiver in a complaint or other document filed to commence a lawsuit). Given that a receivership is a powerful equitable remedy that effectively displaces the governing persons of an entity, courts do not appoint a receiver lightly. Most of the time, the applicant must show fraudulent conduct or other bad behavior on the part of an entity's management. At a minimum, the applicant must show that the business's assets are in jeopardy of losing substantial value, thereby threatening the interests of creditors and equityholders. If a less drastic equitable remedy is available that can protect the interests of creditors or other stakeholders (e.g., a preliminary injunction, which merely preserves the *status quo* until a dispute can be resolved by trial), courts will usually decline to appoint a receiver. For this reason, receiverships are most commonly used when the interests of multiple parties are threatened (e.g., all creditors of a business), as opposed to in a two-party dispute, where an injunction may be sufficient.

Given that fraudulent conduct is almost always secretive in nature, an applicant who suspects that an entity's governing persons have engaged in fraudulent conduct may face an uphill battle in acquiring sufficient evidence to justify appointment of a receiver. An additional problem is that the applicant may not wish to tip off a fraudster that a court action is coming before it is filed, thereby provide the fraudster with a window to fraudulently transfer, or dissipate assets. This is of particular concern if the fraudster has the ability to easily transfer assets to a foreign jurisdiction, given the additional difficulties and cost inherent in recovering assets abroad. As the most difficult step in pursuing fraudulent conduct or recovering assets is determining what course of action best fits the situation, the resources available on the websites for the U.S. Department of Justice, U.S. Department of State, and other agencies are a good place to start.[13]

To the extent possible, it is best for a potential receivership applicant to conduct as much pre-suit investigation as possible prior to filing suit. This should include public record searches (e.g., prior court filings or lien searches), internet searches using a search engine, and review of social media accounts. In particular, social media searches frequently turn up information that can later be used in a lawsuit to uncover fraudulent conduct. The applicant may wish to consider hiring a private investigator. If the applicant already has access to a significant amount of financial information relating to a business, the applicant should consider hiring a forensic accountant to determine if funds have been fraudulently transferred or other suspicious circumstances are present. Some jurisdictions also permit pre-suit discovery (e.g., a pre-suit deposition under Texas Rule of Civil Procedure 202), although the benefits of formal pre-suit discovery when fraudulent conduct is possible are often outweighed by the risks inherent in tipping off a fraudster that litigation is being evaluated. In short, pre-suit investigation can be difficult, but a party should, at a minimum, conduct Internet searches and review social media postings.

As the U.S. permits liberal discovery once a lawsuit has been filed, uncovering fraudulent conduct becomes much easier once a lawsuit is pending. The problem, of course, is that merely filing a lawsuit does not prevent a fraudster from dissipating assets while it is pending without some kind of additional equitable relief in place, like a preliminary injunction or appointment of a receiver. Obtaining either of these types of equitable relief requires more than mere suspicion that fraudulent conduct has occurred. Frequently, the best course of action for a party that has sufficient evidentiary support to file a lawsuit, but not sufficient evidence to obtain a preliminary injunction or receiver, is to file suit and seek expedited discovery, which may be authorized by the court in most jurisdictions.[14] The lawsuit should be accompanied by a request for appointment of a receiver, which the applicant can amend to add additional factual detail if expedited discovery is authorized. The applicant should also consider seeking issuance of a temporary restraining order—a type of temporary injunction that generally lasts only 14-30 days—to preserve the status quo while expedited discovery is conducted.[15] Once sufficient information is obtained through expedited discovery to justify appointment of a receiver, the applicant can request a hearing date with the court.

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[13] *See, e.g.*, U.S. Asset Recovery Tools & Procedures: A Practical Guide for International Cooperation (2017), *available at* https://2009-2017.state.gov/documents/organization/1900690.pdf (Accessed October 11, 2021).

[14] Under Federal Rule of Civil Procedure 11 and its state law equivalents, a litigant must ensure that allegations in the lawsuit have evidentiary support, or at least are likely to have evidentiary support after a reasonable inquiry.

[15] Because of the short lifespan of this type of injunction, courts are more willing to grant a temporary restraining order than a preliminary injunction (which holds the status quo until trial).

Most receivership orders provide a receiver with expansive powers to conduct litigation discovery, obtain documents, and prosecute claims—particularly when fraud is suspected. Therefore, once a receiver has been appointed where fraudulent conduct is suspected, the receiver will usually move quickly to obtain further information. This will generally involve using traditional litigation discovery devices such as requests for production of documents and depositions. If the cost can be justified, a receiver will often employ a forensic accountant to facilitate the review and analysis of financial information.

## 4. What Causes of Action Are Available to a Receiver Once Fraud is Uncovered?

Generally, the receivership order will allow the receiver to prosecute any causes of action belonging to the receivership estate (i.e., any causes of action that otherwise belong to the entity placed into receivership). Below is a non-exhaustive list of some commonly pursued causes of action:

- Fraudulent transfer claims: Virtually every U.S. state has a well-developed body of law that allows creditors to recover fraudulent transfers of money and other property from transferees. These laws are typically codified in the Uniform Fraudulent Transfer Act ("UFTA") or the Uniform Voidable Transaction Act ("UVTA", which is effectively a successor statute to UFTA), depending upon which statute has been adopted by a state.[16] Section 548 of the United States Bankruptcy Code also contains provisions similar to the UFTA and UVTA, but requires the commencement or pendency of a bankruptcy proceeding. Fraudulent transfer law allows for recovery of two types of transfers. The first type are transfers made with actual intent to hinder, delay, or defraud a creditor, referred to as actual fraudulent transfers.[17] To determine whether actual intent to hinder, delay, or defraud exists on the part of the transferor, most courts look to a list of so-called "badges of fraud" to see if any are present, though the list is not exclusive.[18] The second type of avoidable transfer is a constructively fraudulent transfer. This type of transfer does not require actual intent to hinder, delay, or defraud on the part of the transferor.[19] Instead, the transfer must have been made in exchange for less than reasonably equivalent value and while the transferor was either insolvent, undercapitalized, or not paying its debts as

[16] For example, California has adopted by UVTA, while Texas still uses the UFTA.

[17] *See, e.g.*, Tex Bus. & Com. Code § 24.005(a)(1). Strictly speaking, fraudulent intent on the part of the transferor is not required to bring this claim so long as the transfer was at least intended to hinder or delay a creditor's right to collect from the transferor.

[18] *See, e.g.*, Tex. Bus. & Com. Code § 24.005(b).

[19] For this reason, the Uniform Voidable Transaction Act dropped the word "fraudulent" from its title.

they become due.[20] Constructively fraudulent transfer law effectively protects creditors by limiting the extent to which a party with limited assets can transfer those assets for less than reasonably equivalent value. Although fraudulent transfer lawsuits are traditionally brought by creditors, a receiver is typically granted the authority to file such actions to recover assets for the benefit of all creditors of the receivership estate. The lawsuit may be filed against the initial transferee of the transferred property and any subject transferee.[21] In the case of a subsequent transferee, however, a person who took the property in good faith and in exchange for value is immune from a fraudulent transfer suit.[22]

- Breach of fiduciary-duty claims: Frequently, a receivership estate will possess claims for breach of fiduciary duty, most commonly against a corporate entity's current or former officers and directors. Under Delaware law, officers and directors owe duties of care, good faith, and loyalty to the entity.[23] Broadly speaking, these duties require governing persons to avoid conflicts of interest and take actions they believe are in the best interests of the entity after becoming reasonably informed about a particular issue. Most U.S. states impose similar fiduciary duties on governing persons, although the extent of those duties and the exceptions to them can vary considerably among jurisdictions. Although many breaches of fiduciary duty do not involve fraud, fraud committed by a governing person with respect to an entity will generally constitute a breach of fiduciary duty. For example, a chief financial officer who falsifies company financials to procure additional investments has likely not only engaged in securities fraud, but also breached their fiduciary duties. A common remedy for breach of fiduciary duty is disgorgement of ill-gotten gains (e.g., profits) obtained as a result of the breach.

- Restitution/unjust enrichment: A third type of relief frequently sought by receivers is recovery of property or funds obtained unjustly, often referred to as unjust enrichment. Different jurisdictions have various names for causes of action based on unjust enrichment (e.g., quantum meruit or money-had-and-received).[24] Courts sometimes award relief based on restitutionary theories when a party has been unjustly enriched but, for whatever reason, the elements of a cause of action under contract or tort law cannot be

[20] *See, e.g.*, Tex. Bus. & Com. Code §§ 24.005(a)(2), 24.006(a).

[21] *See, e.g.*, Tex. Bus. & Com. Code § 24.009(b).

[22] *Id.*

[23] *See Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (listing fiduciary duties and noting that the duty of good faith is effectively a subsidiary duty of the duty of loyalty). . Traditionally, Delaware law is the most highly developed corporate law in the United States, due to the number of companies incorporated there.

[24] *See, e.g.*, *Hill v. Shamoun & Norman LLP*, 544 S.W.3d 724, 732-33 (Tex. 2018) (discussing elements of quantum meruit claim under Texas law); *Plains Explor. & Prod. Co. v. Torch Energy Advisors Inc.*, 473 S.W.3d 296, 302 n.4 (Tex. 2015) (discussing money-had-and-received claim under Texas law).

established. Therefore, a restitution or unjust enrichment claim is rarely the only claim asserted by a receiver, but is often included in the complaint.

While a receivership offers many advantages to a victim of fraud, it is not perfect and has some disadvantages and drawbacks. First, a state court, unlike a bankruptcy court, may not have significant experience with complex fraud schemes, fraudulent transfer litigation or receiverships. Second, the court selects the receiver (often based on the recommendation of the plaintiff), but the court can decide to appoint someone else. That person may not have the necessary experience or manpower to handle the task. Third, a receivership is not cost free and can be expensive. Typically, receivers are paid from the assets of the estate but if there are no unencumbered assets or assets with equity value above the secured debt, the plaintiff will need to cover the costs, which can be significant. Finally, to frustrate the appointment of a receiver, the fraudster could commence a bankruptcy proceeding, which will stay any action to appoint a receiver and could displace any receiver already appointed. Of course, the filing of a bankruptcy by the fraudster may be a net positive for the impacted creditor for a variety of reasons beyond the scope of this article. These drawbacks and disadvantages, while not exhaustive, must be evaluated in determining whether a receivership is the best option available to an aggrieved creditor.

## 5. Conclusion

When faced with a company engaged in fraud or the dissipation of assets, creditors have to be prepared to use any legal mechanisms at their disposal. Receivership is one such mechanism and it provides numerous advantages discussed herein. However, it is not a perfect mechanism and has some drawbacks that must be considered. Nevertheless, the ability to have a court appoint an experienced third party as an officer of the court with broad powers to stop bad acts, preserve threatened or deteriorating assets, investigate the underlying facts and pursue appropriate claims for recovery is an important weapon and one that has proven effective in many situations involving fraud.

# About the Authors

**Joe Wielebinski**, Shareholder, is a member of Winstead's Business Restructuring/Bankruptcy practice group. For more than 30 years, his practice has concentrated on bankruptcy, creditors' rights and financial restructuring, and he is active throughout the United States in a variety of complex restructuring, insolvency and bankruptcy matters and related litigations.

Joe has represented numerous victims in matters involving complex financial fraud, theft, money laundering and other white-collar crimes. He has also served as a Federal District Court receiver at the request of the SEC in cases involving national and cross-border fraud schemes. Consistently ranked by Chambers USA as a "Leader in Their Field" since 2005, Joe is a frequent speaker and a prolific author on a broad range of topics involving corporate reorganization, insolvency, financial restructuring, fraud, asset recovery and cross-border insolvencies. Joe is the Executive Director Emeritus of ICC-FraudNet and member of its Advisory Board. He is a member of the International Bar Association, International Association for Asset Recovery, American Bankruptcy Institute and Turnaround Management Association.

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Matthias diligently represents clients in almost any kind of contested matter, be it a state court receivership, class action, AAA arbitration, inverse condemnation suite, or other dispute. He also frequently advises firm transactional clients with respect to contract negotiations and business disputes, particularly in the technology and healthcare fields. Matthias has significant fraudulent transfer litigation experience. He has advised foreign clients on asset recovery procedures under US law, as well as represented debtors, creditors, and trustees in virtually all aspects of business bankruptcy proceedings, including contested asset sales and debtor-in-possession financing.

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