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Charles H. Lichtman, counsel to the bankruptcy trustee in the Rothstein Rosenfeldt Adler case, describes the many considerations to take into account when a fraud claim is brought. **A4**

Board of Contributors: The practicality of handling fraud cases

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Fraud is rampant, but there are many issues to consider in bringing litigation or taking actions to recover losses arising out of a fraudulent transaction.

Often, what looks like a fraud and smells like a fraud is, in fact, a fraud. Sometimes the fraud is plainly evident, such as a clear misrepresentation in a contract. However, other times fraud may not be as obvious and will take investigation to prove that the claimed situation was in fact fraudulent, as opposed to an innocent mistake. Thus, an honest assessment of what went wrong and how is mandatory, since fraud charges are serious, and usually cost more to litigate than plain breach of contract actions.

Further, understanding the amount of damage suffered from the fraud is critical, because of both collectability and cost of collectability. Good business sense dictates that even with a deep-pocket defendant one should not pursue a fraud claim on a \$100,000 loss, for example, if alternative

claims can provide a recovery with less expense. Or, one could have a huge dollar claim with clear liability, but with dim collection prospects. The bottom line is that good money should not be thrown after bad, and the fastest and cheapest way to judgment should be pursued.

Notwithstanding, even given the cost issues, psychologically many fraud victims, especially in large frauds, often wish to proceed with bringing a fraud claim, even when properly counseled about other pleading options. In fact, they feel a need to bring a fraud claim to validate that they are victims.

In terms of financial investigation to determine collectability, how does one find reliable information for review and sufficient analysis? Generally, financial privacy laws preclude a detailed investigation of a person's bank accounts or marketable securities, so usually reliable information about these type of assets is not attainable. That doesn't mean, however, that an investigation of a fraud target can't reap meaningful information. A search of public records for real and personal property (being mindful of homestead) or corporate interests through the Department of State can provide great detail as to whether or not a person is collectable.

Also, consider the collection laws in the state the defendant resides in. A guilty defendant could conceivably have millions in assets, but if he lives in the right state and the property is titled jointly, it may be exempt from levy and execution. Florida is known for providing broad debtor protection, even when fraud is committed.

Once a lawsuit begins, discovery rules are broad, and requests for production of documents and/or subpoenas, as part of the fraud investigation, can often lead to a plaintiff being able to review a defendant's tax returns, full banking and financial records, computer files, phone records and countless other documents that suggest places where a defendant's money is located. The most obvious instruction remains "follow the money."

Usually large frauds are not committed by just one person but by a good-sized group, depending on the complexity of the scheme. Understanding that layers of persons are involved in the fraud provides an opportunity to seek recovery from all culpable parties. Moreover, strategically, having a group of defendants involved enables counsel to utilize a "divide and conquer" strategy that pits one defendant against another.

Suing every person who legitimately should be sued creates opportunity to collect money from lower-wrung bad actors while also extracting their testimony against the main perpetrators. The main culprits may have the stomach and financial ability to fight, but those at the bottom may want no part of a long and expensive fraud lawsuit. It is not uncommon to trade truthful testimony against other bad actors for dismissal from the action at a lesser settlement price.

There can be a wide net of target defendants. Larger frauds, such as in Ponzi schemes or securities frauds, often involve bribery, kickbacks or excessive compensation payments to get third parties to turn a blind eye, or manipulate data that causes the fraud. This involvement gives the fraudulent transaction some credibility; but it also makes these people liable under the law.

Depending on the nature of the fraud, attorneys and accountants may be liable, and they are historically targets in fraud cases. Any professional who has prepared incorrect financial or transactional documents during the fraud that the victim reviewed, relied upon, and which induced the transaction in question is at risk for being sued. Those professionals who actively promoted the scheme face even greater exposure.

Understanding the professional's insurance is also critical. Pleading a claim against professionals can be tricky because most professionals' policies contain an exclusion from coverage for fraudulent conduct. Thus, plaintiff's counsel will have to be creative in stating claims and allegations so that the insurer does not deny coverage upon review of the complaint. Alternate claims to fraud, depending on the facts and applicable law, include negligence or breach of fiduciary duty. Though not elaborated on in this article, part of due diligence in proceeding against professionals encompasses a thorough understanding of co-conspirator, aider or abettor, and secondary liability.

In terms of securities fraud, particularly Federal Rule 10b-5 actions involving insider trading, consideration should be given to bringing claims that are easier to plead and sustain. Common law fraud can be pleaded against most primary and secondarily liable persons. State securities Blue Sky claims are often less pleading restrictive than federal securities claims. Keep in mind the objective is to cost-effectively obtain the maximum recovery for the client. Thus, if counsel can alleviate case expense and still get a good result by avoiding the pleading and proof issues on more difficult claims, then such strategy must be considered.

Another strategy to consider, particularly in larger fraud cases, is seeking the appointment of a receiver for the corporate entity involved in the fraud. A receivership should be contemplated where records must be immediately sequestered and assets of the entity must be preserved. Proceeding with a receivership requires a cost-benefit analysis, but removing the bad actors from the business and putting it into the hands of an experienced receiver with a fraud background may be the best way to go.

Consideration must be given to what to do when the fraud rises to the level of criminal activity, which is usually the case. Counsel must understand the client's objective. Is it more important for the client to get repaid or to punish the wrongdoers? Once a criminal referral has been made to the authorities and an investigation begins, there is a substantial likelihood that the fraudulent actor will have to devote financial resources to defending himself at the criminal proceeding, rather than the client's case. Among other considerations, it raises problems in terms of access to proof if prosecutors take custody of documents necessary to prove a lawsuit.

In sum, there are many practical considerations that must be taken into account every time a fraud claim is brought. Underlying all of them ought to be the issue of practicality, recoverability and cost.

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