

AMERICAN BANKRUPTCY INSTITUTE

ABI/UMKC Midwestern Bankruptcy Institute

Options When Fraud Is Discovered in Commercial Cases

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CONCURRENT SESSION

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Midwest Bankruptcy Institute
Options when Fraud is Discovered Written Materials

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Learning Objectives

1. Attendees will identify common indicators of fraud in distressed businesses and distinguish genuine fraud from signs of mere management incompetence, including the heightened pleading and intent requirements that separate the two.

2. Attendees will evaluate the range of options available once fraud is discovered or confirmed including appointment of a receiver, civil claims against the fraudster (fraudulent transfer, breach of fiduciary duty, veil piercing, unjust enrichment), and referral to law enforcement while managing the competing interests of lenders, investors, and management during an investigation.

3. Attendees will assess the practical and legal threshold questions that determine whether to pursue fraud-related claims, including standing, statute of limitations and tolling issues, and collectability considerations such as available insurance coverage and claims against subsequent transferees.

Introduction

- Fraud continues to be a pervasive problem that businesses face throughout the United States.
    - A study by PwC indicated that 31% of companies reported fraud caused by internal perpetrators, as compared to external participants or cyber risks. PwC, Global Economic Crime and Fraud Survey, 2022. Protecting the perimeter: The rise of external fraud (PwC's Global Economic Crime and Fraud Survey 2022).
- This creates significant questions for lenders, investors, and other interested parties:
    - What are the signs of fraud?
    - What steps should be taken to investigate?
    - What are the costs and benefits of pursuing an investigation?
    - What is the potential recovery?

Threshold Considerations in Fraud Matters

- There are a number of "red-flags" that can be indicative that fraudulent conduct has occurred, or is occurring. These indicators include:

- A senior manager that dominates operating decisions.
- Ineffective board leadership or influence of the board by management.
- High management turnover, particularly in the CFO, treasurer, controller or similar positions.
- Rapid expansion in excess of industry averages.
- Significant litigation.
- Large or unusual transactions that have a material effect on earnings, particularly if they occur at the end of the year.
- Excessive increases in inventory.
- Large or unusually structured transactions that are uncommon in the industry.
- High turnover in accountants or audit firms.

See § 7:10. Conditions and events that may signal fraud by corporate management, Mod. Corp. Checklists § 7:10

- Differentiating between fraud and incompetence.
  - Many of the signs of fraud can also show up when management is incompetent, or the business has grown beyond management's skillset and abilities.
  - Distinguishing the difference between fraud and incompetence is important, because fraud-related claims generally include an element of intent.
    - Fraud claims will be subject to a higher pleading standard under the Federal Rules of Civil Procedure and similar state court rules of civil procedure. *See* Fed. R. Civ. P. 9(b).
    - Intent is a requirement for fraudulent transfer claims under the "actual fraud" standard. *See Kibler v. Wooters*, 2007 WL 1756595, at *4 (Del. Ch. June 6, 2007).
      - The statutory "badges" of fraud for fraudulent transaction claims may also be used to imply actual intent.
      - Fraudulent transfer statutes also allow "constructive" fraudulent transfer claims upon a showing "(i) that the transferor failed to receive reasonably equivalent value for the asset transferred; and (ii) that the transferor was insolvent at the time of the transfer or was rendered insolvent by the transfer." *In re Samson Res. Corp.*, 2023 WL 4003815, at *24 (Bankr. D. Del. June 14, 2023) (citing 6 Del. C. §§ 1304(a)(2), 1305(a)).

- State law fraud claims also require a showing that the defending party knowingly made a false statement, and with the intent to deceive. *See Albers v. Nelson*, 248 Kan. 575, 579, 809 P.2d 1194 (1991).

- Overlap with the warning signs of fraud can include:
  - A controlling senior manager or owner is a hallmark in many closely held companies and is commonly found in entrepreneurs.
  - High turnover may be a symptom of financial distress more generally as employees and officers look for a more stable employment situation and better opportunities.
  - Large or unusual transactions, or excessive increases in inventory, may be the result of poor planning by the company or overly optimistic projections of expansion.
- As an illustrative example, the Texas Supreme Court recently denied a characterization of a claim against an accountant as a fraud claim when "the gravamen of the fraud claim is that the Accountants knew they were incompetent but proceeded anyway, which led to mistakes they later knew about[,]" which raised serious questions regarding professional misconduct, but demonstrated "no evidence that the Accountants were engaged in a fraudulent scheme against [the claimant] or that they otherwise intended to harm him." *Pitts v. Rivas*, 709 S.W.3d 517, 527 (Tex. 2025).

- The investigation of fraud claims may also be complicated by the various competing interests of the stakeholders.
  - Generally, in cases where a receiver is appointed, the lender who obtained the appointment is funding the receivership and may have strong opinions as to whether or not fraud claims should be investigated or pursued.
  - Outside investor groups may have an interest in pursuing fraud claims to try and realize some recovery on their investment, even when the lender or other parties do not feel that the investigation and prosecution of the claims will be beneficial.
  - The management team, even if not participants in the fraud, may be concerned about continuation of the business and the reputational and economic harms that fraud allegations may create for the business and for individuals personally.
- To deal with potential competing interests, the fraud investigator should have clear conversations with stakeholders at the beginning of an engagement to ensure all parties understand the parameters of the investigation.

- The investigator should also have "check in" points with the party funding the investigation to ensure they have visibility into the process before costs are incurred so there is transparency in the process and clarity on the cost before professional fees and other expenses are incurred.

Options When Fraud is Discovered

- If suspicions of fraud are confirmed following the investigation, there are a number of options that may be pursued to address the fraud.
  - Appointment of a receiver: depending on the jurisdiction, establishing the existence or potential of fraudulent activity is a requirement to obtain the appointment of a receiver over the defendant. *See e.g., Aviation Supply Corp. v. R.S.B.I. Aerospace, Inc.*, 999 F.2d 314, 316-17 (8th Cir. 1993).
    - However, some states are more lenient in allowing appointment of a receiver, and a showing of fraud may not be required if the request is supported by other grounds (i.e. contractual agreement, recovering rent payments, protecting assets, etc.). *See e.g.,* RSMo. § 515.510 (outlining the potential grounds for appointment of a receiver under the Missouri Commercial Receivership Act).
    - A receiver has the benefit of stepping into the management role and stopping fraudulent activity but will have to take additional action (such as filing suit) to recover any fraudulently transferred assets or to seek money damages.
  - File suit against the party that perpetrated the fraud – Claims may include[1]:
    - Common law fraud claims
      - Elements generally include: (1) an untrue statement of material fact; (2) which is known by the defendant to be untrue; (3) made with the intent to deceive or with reckless disregard for the truth of the statement; (4) plaintiffs justifiably relied on the statement; and (5) some injury resulted from such statement. *Albers v. Nelson*, 248 Kan. 575, 579, 809 P.2d 1194 (1991).
      - May not be applicable when fraud is committed by an insider.
    - Fraudulent transfer claims

[1] The elements of fraud-related claims will be state specific, but Kansas case law is used as an illustrative example.

- Actual fraud standard – requires establishing that a transfer was made "[w]ith actual intent to hinder, delay or defraud any creditor of the debtor…" K.S.A. § 33-204(a)(1); *See also Koch Engineering Co. v. Faulconer*, 239 Kan. 101, 105 (1986).
    - Court may look to "badges of fraud" which can be used to establish actual intent. These include whether: (1) the transfer was made to an insider; (2) the debtor retained control of the property after the transfer; (3) the transfer was concealed; (4) the debtor was threatened with suit or sued before the transfer was made; (5) the transfer was of substantially all of the debtor's assets; (6) the debtor fled the jurisdiction after the transfer; (7) the debtor hid or removed assets; (8) the value of the consideration given for the transfer was not reasonably equivalent to the money or property transferred; (9) the debtor was insolvent at the time of the transfer, or became insolvent shortly after the transfer was made; (10) the transfer was made shortly before or after a substantial debt was incurred; and (11) the debtor transferred essential assets of the business to a creditor, who then transferred those assets to an insider of the debtor. K.S.A. § 33-204(b)(1)-(11).
    - These various "badges of fraud," however, are not exhaustive and may be supplemented by case law or the specific facts of a given case. *See Koch Engineering Co.* 239 Kan. at 105 (outlining badges of fraud under the common law).
- Constructive fraud standard
    - A claimant may establish a transfer is fraudulent under the constructive standard if (1) it is made without receiving reasonably equivalent value and (2) the debtor was either: (i) engaged in a transaction for which the remaining assets of debtor were unreasonably small or (ii) the debtor intended to incur, or believed it would incur, debts beyond its ability to pay when due. K.S.A. § 33-204(a)(2); *Digital Ally, Inc. v. Culp McAuley, Inc.*, 2024 WL 2260573 at *10-11 (D. Kan. May 17, 2024).
    - Fraudulent transfer claims are generally easier to establish under the constructive standard, particularly in distressed situations where insolvency is a concern.

▪ Breach of fiduciary duty claims

- Generally requires a showing of: (1) the existence of a fiduciary duty; (2) breach of that duty; and (3) damages resulting from that breach. *See Schneider v. Kansas Sec. Comm'r*, 397 P.3d 1227, 1247 (Kan. 2017).
- Applicable to officers, directors and others that owe fiduciary duties, but may not be applicable if fraud was committed by someone not in management.

▪ Piercing the corporate veil

- Generally requires a multifactor test that can consider, among other things, (1) total control or ownership; (2) common directors and officers; (3) recognition of corporate formalities and record keeping; (4) adequate capitalization; and (5) whether the company acts independently. *Triplett, Inc. v. Ol'Mac Motors, Inc.*, 154 P.3d 1184 (Kan. Ct. App. 2007).
- Veil piercing may be necessary to the extent an owner/parent company fraudulently misappropriates business assets or engages in self-dealing.

▪ Unjust enrichment claims

- Generally, requires a showing that there is (1) a benefit conferred on the defending party by the claimant; (2) that the defending party appreciated or had knowledge of the benefit; and (3) that acceptance or retention by the defending party of the benefit would be inequitable without payment of its value. *Jones v. Culver*, 50 Kan. App. 2d 386, 390 (2014).

o Alert law enforcement.

▪ Fraud may also rise to a level where it becomes necessary to involve law enforcement.

▪ Criminal statutes applying to fraud are beyond the scope of this CLE.

▪ Alerting law enforcement can be powerful if the agency elects to investigate and pursue the case, but these agencies will not have any obligation to keep the stakeholders apprised of their progress and any recoveries from restitution or otherwise may be limited or uncollectable.

- Important Considerations Before Bringing Claims.

o Does the investigator/party have standing to bring the claims?

▪ Depending on the jurisdiction, a receiver generally has standing to bring claims on behalf of the insolvent company.

- These include claims for breach of fiduciary duty claims, fraudulent transfer, tort, unjust enrichment and any other claims that resulted in damage to the company itself. *See Bartholomew v. Avalon Cap. Grp., Inc.*, 828 F. Supp. 2d 1019 (D. Minn. 2009) (finding that a receiver could bring claims for fraudulent transfer, breach of fiduciary duty, and unjust enrichment under Minnesota law).

▪ Receiver may be limited in bringing some claims.

- Generally cannot bring claims belonging to third parties, such as individual investors, creditors or other parties in interest.
- Some jurisdictions provide that the receiver is subject to the same defenses as the corporation would be if it had brought the claim absent the receivership.
  - These potential defenses include unclean hands, in pari delicto and ratification.
  - Whether or not these defenses are applicable will depend on the jurisdiction. *Compare Knauer v. Jonathon Roberts Fin. Group*, 348 F.3d 230, 238 (7th Cir. 2003) (barring a receiver's claims under the *in pari delicto* defense) *with Jo Ann Howard & Assocs., P.C. v. Cassity,* 79 F. Supp. 3d 1001, 1017 (E.D. Mo. 2015) (*in pari delicto* did not bar receiver's claims).

o What is the statute of limitations for the claim?

▪ Statutes of limitation will vary by state and the type of claim that is being brought. *Compare* Ark. Code Ann. § 16-56-105 (3-year statute of limitations for fraud) *with* Iowa Code Ann. § 614.1 (5-year statute of limitations for fraud).

▪ While tolling of the statute of limitations may be available where the fraudulent activity has been concealed, it may be unclear when the tolling begins and ends.

- A receiver may not be able to argue that the statute of limitations is tolled if they are imputed with the knowledge of the corporation. *See Resol. Tr. Corp. v. Armbruster*, 52 F.3d 748, 751 (8th Cir. 1995) (declining to apply the "adverse dominion" doctrine to toll the statute of limitations on a receiver's claims).

▪ Given that it is unclear whether the statute of limitations is tolled, and variation in applicable law, it is important to analyze potential claims and enter into tolling agreements if necessary to ensure that claims are preserved while the investigation proceeds.

o How will any judgment be collected?

- Ultimately, even the strongest claims may not be worth pursuing if there is no possibility of collection of a judgment.
- Collectability should be part of the threshold analysis of a claim and before significant costs are incurred.
  - Does the defendant have personal assets?
    - Consider whether there will be a race to judgment and competing creditors.
    - Even if the defendant does not have personal assets, consider whether a personal judgment opens up other avenues for collection (i.e. through insurance, indemnification rights, etc.).
  - Through veil piercing
    - Do parent companies or ultimate owners have assets that could satisfy a judgment? If so, then a veil piercing claim could provide avenues for recovery that may not otherwise be available.
- Available insurance contracts
  - Availability of insurance proceeds will depend on the provisions of the applicable insurance agreement.
    - Importance of considering policy structure.
      - May be an "insured vs. insured" exclusion that prevents a receiver from bringing coverage, although many policies include carve-outs for claims brought by receivers and trustees.
      - Some D&O policies bar coverage for deliberate fraudulent acts, criminal conduct, or actions taken for personal profit.
      - Type of coverage may impact whether any recovery is available for the receiver.
        - "Side A" coverage protects individual directors and officers when the corporation cannot indemnify them.
        - "Side B" coverage reimburses the company for money it spends indemnifying its directors and officers for their defense or settlements.
        - "Side C" coverage applies to the company for certain classes of claims.
      - Liability limits may also impact total possible recovery.
      - In sum, whether or not an insurance policy provides an avenue for recovery is going to depend on the provisions of the specific policy at issue, and close review is required to determine whether recovery is available.

- Subsequent transferees
  - Fraudulent transfer claims may also be brought against transferees. *See* 6 Del. C. § 1308(b).
  - Transferees may have defenses if they took the property in good faith and for reasonably equivalent value. *See* 6 Del. C. § 1308(a).
  - Recovery from transferees may require tracing the chain of payments/transfers, and may be complicated, time intensive and expensive.

Speaker Biographies

Krista L. Freitag, Principal – E3 Advisors

Since co-founding E3 Advisors in 2011, Ms. Freitag and E3 have provided federal equity and state receivership, trustee, and advisory services for more than 150 projects located throughout the United States. Such projects range from international and domestic fraud cases representing more than $1 billion of alleged fraudulent activity to operating businesses to various real estate asset classes including retail, hospitality, multi-family, and single-family residential, assisted-living facilities, quick-service restaurants, industrial facilities, and raw land. Ms. Freitag has served as Receiver for retail assets alone exceeding $300 million of asset value. She has also served as Receiver or Monitor in various United States Securities and Exchange Commission, Consumer Financial Protection Bureau, and Federal Trade Commission cases throughout California and Idaho exceeding $700 million of alleged fraudulent activity.

Prior to founding E3 Advisors, Ms. Freitag served as Managing Director and Consultant for Douglas Wilson Companies for nearly nine (9) years. Ms. Freitag provided project management, asset management, property management, accounting, forensic accounting, financial analysis, and homeowner's association services for dozens of clients, real estate assets, and operating businesses throughout the United States. She provided project management services for receivership assets exceeding $400 million of asset value and managed the disposition of nearly $100 million worth of retail and operating business assets.

Before joining Douglas Wilson Companies, she worked as an Investment Manager for Brio Investment Group, where she managed and analyzed a multi-million dollar private investment portfolio, which primarily included multi-family, boutique hotel, and private equity assets. Before joining BRIO Investment Group, she worked for the REIT,

Burnham Pacific Properties, where she prepared and coordinated the company's SEC reporting, prepared and coordinated portfolio performance reports for management and outside investors, coordinated the quarterly and year-end audits, and monitored and analyzed all leasing activity for the 100 property/2,000 tenant portfolio (including CalPER's managed portfolio).

Ms. Freitag holds a MS in Business Administration with a concentration in Finance from San Diego State University, a BS in Accounting from Northwestern Oklahoma State University, and a Master Certificate in Essentials of Hospitality Management from Cornell University's School of Hotel Administration. Ms. Freitag is a member of the ICSC, National Association of Federal Equity Receivers (NAFER) and the California Receivers Forum (CRF). She served on the Board of Directors for the San Diego-based Women's Empowerment, Inc., a conduit for microcredit financing in impoverished countries, and was a San Diego County 2009 Tribute to Women in Industry (TWIN) Award honoree.

James Cullen, Founder & CEO – Steeplechase Advisors LLC

Mr. Cullen is the Founder and CEO of Steeplechase Advisors LLC. He is a nationally recognized leader in the US middle market restructuring industry with 30+ years of experience leading companies and financial institutions in restructurings and business reorganizations in formal and informal legal proceedings. He has served in the role of Board Advisor, CEO, CRO and Investment Banker and has led and completed over 250+ restructuring, refinancing and reorganization processes in North America, Europe, Asia, and Australia for companies encountering operational and financial challenges. He is a subject matter expert and has testified as an expert witness in multiple federal and district courts throughout the United States on restructurings and sale processes. He has been federally court appointed and approved by federal bank regulators to lead and manage multiple financial institutions through reorganizations and recapitalizations while under formal federal bank enforcement actions.

Clients include financial institutions, public companies, privately held, equity sponsored and family- owned businesses in multiple industry sectors including retail, manufacturing, consumer products, real estate, agriculture, and financial services.

Mr. Cullen is a member of the TMA, a recognized speaker and presenter, and has served on multiple continuing education panels, to the financial and legal community.

He is a graduate of Trinity College Dublin, Ireland and is a dual US and EU Citizen.

Kate Lattner, Managing Director – Novo Advisors

Kate Lattner is a Managing Director at Novo Advisors, where she helps lead the firm's Forensic & Dispute Advisory practice. She brings nearly two decades of experience advising law firms, in-house counsel, corporate management, boards of directors and audit committees, trustees, receivers, and court-appointed fiduciaries on complex forensic accounting, litigation, and investigative matters, with a particular focus on bankruptcy, restructuring, and distressed situations, including offshore and cross-border engagements.

In bankruptcy and restructuring matters, Kate conducts in-depth forensic investigations and financial analyses across both investigative and litigation-related contexts. Her work frequently involves analyzing fraudulent transfer and preference claims, evaluating improper distributions and breaches of fiduciary duty, investigating Ponzi and other investment-related schemes, and performing complex asset tracing and accounting reconstruction.

Kate regularly leads forensic and investigative matters involving alleged fraud and other financial misconduct, including white-collar and internal investigations. She also frequently serves as an expert witness on matters involving economic damages, asset misappropriation, and accounting irregularities.

Kate has extensive experience with post-acquisition disputes, including working capital adjustments, earn-outs, and breaches of representations and warranties. She advises buyers, sellers, and private equity sponsors on accounting-driven disputes, including evaluating potential breaches, quantifying damages, and interpreting purchase agreement provisions.

Clients value Kate for her disciplined, precise approach to forensic analysis and her ability to quickly isolate the issues that matter most. She is known for her strong investigative judgment and for translating complex financial and accounting issues into clear, defensible analyses and written submissions that help counsel and fiduciaries move matters forward with confidence.

Kate is a Certified Public Accountant and is an active member of professional organizations such as the International Women's Insolvency and Restructuring Confederation, the Turnaround Management Association, and the Women in White Collar Defense Association. She has deep philanthropic ties to the March of Dimes, Joffrey Ballet and Big Careers Little Kids.

Faculty

James Cullen is a senior managing director in the Strategic Advisory Group of J.S. Held in Minneapolis, having joined J.S. Held's Strategic Advisory Group in August 2026 as part of J.S. Held's acquisition of Steeplechase Advisors. He is a nationally recognized leader in the U.S. middle-market restructuring industry with more than 30 years of experience leading companies and financial institutions through restructurings and business reorganizations in formal and informal legal proceedings. Mr. Cullen has served as board Advisor, CEO, CRO and investment banker, and has led and completed more than 250 restructuring, refinancing and reorganization processes in North America, Europe, Asia and Australia for companies facing operational and financial challenges. He is a subject-matter expert and has testified as an expert witness in multiple federal and district courts throughout the U.S. on restructurings and sale processes. Mr. Cullen has been federally court-appointed and approved by federal bank regulators to lead and manage multiple financial institutions through reorganizations and recapitalizations while under formal federal bank enforcement actions. He leads turnaround management and transaction advisory engagements, providing consulting services to businesses, lenders, investors, receivers, creditors and courts in connection with reorganizations, restructurings, distressed transactions and insolvency proceedings. Mr. Cullen is a member of the TMA, a recognized speaker and presenter, and has served on multiple continuing education panels for the financial and legal community. Mr. Cullen holds dual EU/U.S. citizenship and received his Bachelor of Business Studies (Hons) from Trinity College Dublin, Ireland.

Krista L. Freitag is a co-founder of E3 Advisors in Los Angeles and has provided federal equity and state receivership, trustee and advisory services for more than 150 projects located throughout the U.S. since 2011. Such projects range from international and domestic fraud cases representing more than $1 billion of alleged fraudulent activity to operating businesses to various real estate asset classes, including retail, hospitality, multi-family and single-family residential, assisted-living facilities, quick-service restaurants, industrial facilities and raw land. Ms. Freitag has served as receiver for retail assets alone exceeding $300 million of asset value. She has also served as receiver or monitor in various U.S. Securities and Exchange Commission, Consumer Financial Protection Bureau and Federal Trade Commission cases throughout California and Idaho exceeding $700 million of alleged fraudulent activity. Prior to founding E3 Advisors, Ms. Freitag served as managing director and consultant for Douglas Wilson Companies for nearly nine years, where she provided project-management, asset-management, property-management, accounting, forensic accounting, financial analysis and homeowner's association services for dozens of clients, real estate assets and operating businesses throughout the U.S. She is a member of the ICSC, National Association of Federal Equity Receivers (NAFER) and the California Receivers Forum (CRF). She also served on the board of directors for the San Diego-based Women's Empowerment, Inc., a conduit for microcredit financing in impoverished countries, and was a San Diego County 2009 Tribute to Women in Industry (TWIN) Award honoree. Ms. Freitag received her B.S. in accounting from Northwestern Oklahoma State University, her M.S. in business administration with a concentration in finance from San Diego State University, and a Master Certificate in essentials of hospitality management from Cornell University's School of Hotel Administration.

Kathryn Lattner, CPA is a managing director at Novo Advisors in Chicago, where she helps lead the firm's Forensic & Dispute Advisory practice. She brings nearly two decades of experience advising law firms, in-house counsel, corporate management, boards of directors and audit committees, trustees, receivers, and court-appointed fiduciaries on complex forensic accounting, litigation and investigative matters, with a particular focus on bankruptcy, restructuring, and distressed situations, including offshore and cross-border engagements. Ms. Lattner received both her B.S. and M.S. in accounting from the University of Colorado at Boulder.