

**UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF FLORIDA  
ORLANDO DIVISION**

**In re:**

**LOUIS J. PEARLMAN, et al.,**

**Debtors.**

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**Case No. 6:07-bk-00761-ABB**

**Chapter 11**

**Jointly Administered**

**STATUS REPORT**

Soneet R. Kapila, the Chapter 11 Trustee (the "Trustee") for the bankruptcy estates of Louis J. Pearlman ("Pearlman"); Louis J. Pearlman Enterprises, Inc. ("LJPEI"); Louis J. Pearlman Enterprises, LLC ("LJPEL"); TC Leasing, LLC ("TCL"); Trans Continental Airlines, Inc ("TCA"); Trans Continental Aviation, Inc. ("TCAV"); Trans Continental Management, Inc. ("TCM"); Trans Continental Publishing, Inc. ("TCP"); Trans Continental Records, Inc. ("TCR"); Trans Continental Studios, Inc ("TCS"); and Trans Continental Television Productions, Inc. ("TCTV") (collectively the "Debtors"), makes this Status Report to the Court.

Upon appointment as the Chapter 11 Trustee for the jointly administered Debtors, as one of my first tasks, I gathered and assembled the Debtors' financial books and records and all other available financial information and began a forensic analysis of the books, records, and other financial information. Early on, we realized that we were facing an investigation of in excess of \$300 million in transfers made by the Debtors during the four (4) years preceding the Debtors' bankruptcy filings, some of which transfers were in furtherance of the "Ponzi" scheme admitted to by Pearlman.

On April 2, 2007, my professionals began their investigation, which included the review of over 2,000 boxes of records located at the offices of TCA in Orlando in an effort to identify potential assets and accounts of the Debtors. The boxes contained both financial and non-

financial records. My accounting professionals, Kapila & Co. ("KC") coordinated efforts with JH Cohn CPAs ("JH Cohn") to investigate the QuickBook ("QB") records of the Debtors and arranged to review records recovered by the Federal Bureau of Investigations during its initial raid of TCA's offices and Pearlman home. KC also called upon the State of Florida's Office of Financial Regulation to provide me with the bank records it had obtained and analysis it had performed related to the TCA Employee Investment Savings Account ("EISA") program.

By early May 2007, I had obtained a population of records from the various sources referenced above that my professionals and I believed were as complete as possible before seeking additional records through the subpoena process. KC had identified over 150 bank accounts of the numerous entities associated or affiliated with Pearlman. KC began a total reconstruction of the bank accounts, initially focusing on those entities that KC, along with JH Cohn, identified as having the most significant activity based on the review of the QB records. During this process, my professionals and I were in constant communication with the Creditors' Committee regarding these efforts. Importantly, the QB and other financial records were often incomplete and could not be relied upon. Therefore, my professionals had to obtain financial information, including bank statements, copies of checks, loan documents, and other information from third parties and banking/financial institutions. In order to obtain the information and documents, my legal professionals were required to issue subpoenas on an account by account basis on numerous institutions, which in many cases were met with unfavorable responses due to the magnitude of the records and time involved in researching the various accounts of the Debtors. The subpoenaed documents were produced sporadically over the next year and a half. Although my professionals worked expeditiously in identifying and obtaining financial records, the process of accumulating the financial records took approximately two (2) years. By early

2009, I had received substantially all of the records subpoenaed, although there were still some missing items not produced by banking institutions. KC completed the bank reconstruction which has served as the primary basis for the fraudulent transfer actions.

During the time that my professionals were gathering and assembling the financial information and conducting the forensic analysis, we identified known assets of the Debtor entities and monetized those assets. The information on the amounts collected are contained in my monthly reports filed with the Court. My professionals and I continue to identify, locate, and monetize assets of the Debtors for the benefit of the Debtors' estates.

Once the forensic analysis was substantially complete<sup>1</sup> and we identified the persons and entities who had received monies from the Debtors, the statute of limitations deadline was fast approaching (and, in fact, was less than three (3) months away). Although my professionals had taken numerous depositions over the course of the two (2) years, it was impossible to take the depositions of every person who had received monies from the Debtors. Moreover, such an exercise would have been cost prohibitive given the limited financial resources in the estates combined with the Herculean effort that would have been required to depose in excess of seven hundred (700) persons and entities. Instead, based on the available records and information, my professionals and I identified litigation "targets," i.e., persons and entities who would be sued for receiving a preference or fraudulent transfer.

Therefore, knowing that we had a prima facie case against each targeted person or entity,<sup>2</sup> the decision was made to consider bringing an adversary proceeding against any person or entity

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<sup>1</sup> Though the forensic analysis is complete with respect to the vast majority of accounts, it continues with respect to a handful of accounts.

<sup>2</sup> With respect to Ponzi schemes, courts generally recognize:

Transfers made in furtherance of Ponzi schemes have achieved a special status in fraudulent transfer law. Proof of a Ponzi scheme is sufficient to establish the

who received more than \$20,000.00 in transfers from the Debtor entities in the four (4) years prior to the Petition Dates. In doing so, we brought suits against persons and entities who received funds from the EISA program, persons and entities who received funds for purchases of stock, vendors, law firms and banks/financial institutions.

We have received inquiries from various creditors regarding the decision to sue those persons and/or entities who did not receive a profit, i.e., non-profiteers. That decision is supported by the case law.<sup>3</sup> In making the decision to file lawsuits against the non-profiteers, my professionals and I always contemplated setting up a procedure to address those defendants who had a good faith defense. From the time that the lawsuits were filed, a lawyer and paralegal at the Akerman Senterfitt ("Akerman") law firm was designated to handle calls from the defendants

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Ponzi operator's actual intent to hinder, delay, or defraud creditors for purposes of actually fraudulent transfers under Bankruptcy Code § 548(a)(1).

Plotkin v. Pomona Valley Imports, Inc. (In re Cohen), 199 B.R. 709, 717 (BAP 9th Cir. 1996)); see also Bauman v. Bliese (In re McCarn's Allstate Finance, Inc.), 326 B.R. 843, 850 (Bankr. M.D. Fla. 2005); Gredd v. Bear Stearns Securities Corp. (In re Manhattan Investment Fund, Ltd.), 359 B.R. 510, 517-18 (Bankr. S.D.N.Y. 2007); Hayes v. Palm Seedlings Partners-A (In re Agricultural Research and Technology Group, Inc.), 916 F.2d 528, 535 (9th Cir. 1990) ("For example, the debtor's actual intent to hinder, delay or defraud its creditors may be inferred from the mere existence of the Ponzi scheme"); Cuthill v. Greenmark, LLC (In re World Vision Entertainment, Inc.), 275 B.R. 641, 658 (Bankr. M.D. Fla. 2002) ("As discussed above, all payments made by a debtor in furtherance of a Ponzi scheme are made with actual fraudulent intent") (emphasis in original). "When the existence of a Ponzi scheme is proven by the evidence[,], a presumption of actual fraudulent intent is applied." Cuthill v. Kime (In re Evergreen Security, Ltd.), 319 B.R. 245, 253 (Bankr. M.D. Fla. 2003).

<sup>3</sup> “[A]ll payments made by a debtor in furtherance of a Ponzi scheme are made with actual fraudulent intent. Some of these payments are properly avoidable; others are not. None are automatically avoidable. Courts must assess the good or bad faith of each recipient to determine which are avoidable and which are not.” In re World Vision Entertainment, Inc., 275 B.R. at 658 (entering judgment for commission payments to brokers in furtherance of Ponzi scheme) (emphasis added). “Good faith is an objective standard. To determine whether a transferee acted in good faith for purposes of section 548(c), the court must look at what the transferee objectively ‘knew or should have known,’ and conclude that the transferee did not act in good faith because it had sufficient knowledge to place it on inquiry notice of the voidability of the transfer of the debtor’s insolvency.” In re Evergreen Security, Ltd., 319 B.R. at 254 (holding broker liable to trustee under § 548(a)(1)(A) for commission payments made pursuant to Ponzi scheme) (citations omitted). If an investor knew or should have known that a debtor's investment scheme was a Ponzi scheme, a trustee is entitled to recover all amounts the investor received from the debtor, including what would be considered a return of an investor's principal investment or deposit. See, e.g., Scholes v. Lehmann, 56F.3d 750, 759 (7th Cir. 1995) (stating that in cases of actual fraud, an investor "is not entitled to keep *any* part of the money she received from the corporations--provided, we emphasize, that she knew or should have known of [the debtor's] fraudulent intent.") (emphasis added); In re Bayou Group, LLC, 396 B.R. 810 (Bankr. S.D.N.Y. 2008) (holding same).

and to deal with settlement issues with the defendants. Akerman set up a dedicated telephone number and line to handle the calls from adversary defendants.

Shortly after the over-700 lawsuits were filed, on May 15, 2009, certain of my professionals and I met with the Unsecured Creditors Committee and its counsel. Based on the input of the Creditors' Committee and from subsequent conversations with counsel for the Creditors' Committee, my professionals and I formalized the procedures to address those defendants who wanted to assert a good faith defense and, if the facts supported such a defense, to dismiss the lawsuits against those Defendants. To that end, on June 16, 2009, my professionals filed the Motion to Establish and Implement Omnibus Procedures for Resolving and/or Settling Certain Adversary Proceedings (Dkt. No. 2497; the "Settlement Motion"). The purpose of this Settlement Motion is to address at the front end those defendants who have a good faith defense without the unnecessary expenditure of estate resources (or resources of the adversary proceeding defendants). The Settlement Motion contemplates that certain of the defendants will have the opportunity to fill out a declaration and to provide it for review. My professionals and I will then examine the declaration and, if a good faith defense has been shown, my professionals will dismiss the lawsuit against that defendant. This will hopefully avoid unnecessary expenses to be incurred by either side.

In going through the process of making the decision to file a lawsuit against any person or entity who received more than \$20,000.00 in the four (4) years prior to the Petition Date, I did so with a mindset that there are certain persons and entities who did not make a profit but who knew about the Ponzi scheme. I did not think that it was fair to other creditors that those persons or entities not have to return all the monies they received when they were potentially complicit in

the Ponzi scheme and potentially allowed the Ponzi scheme to continue to the detriment of the other creditors.

In addition to the Settlement Motion that has been filed, my professionals are finalizing a motion regarding an omnibus discovery protocol and case management procedure for the remaining adversary proceedings. In fact, the discovery protocol and case management procedure motion has been circulated to counsel for Creditors' Committee and certain of the adversary proceedings defendants' counsel for consideration and input and will be filed with the Court within ten (10) days.

The hearing on the Settlement Motion is scheduled for July 16, 2009. My professionals and I welcome any and all comments to the Settlement Motion and the declaration and, if appropriate, will incorporate suggested changes and present those to the Court at the July 16, 2009.

Dated: July 11, 2009

/s/ Soneet R. Kapila  
Soneet R. Kapila, Chapter 11 Trustee