Special Litigation & Arbitration Issue

# THE INTERNATIONAL LAW Quarterly

A PUBLICATION OF THE FLORIDA BAR INTERNATIONAL LAW SECTION

www.floridabar.org • www.internationallawsection.org

Vol. XXX, No. 2
Spring 2012

IN THIS ISSUE:



## The 2012 ICC Rules of Arbitration

**By Kate Wilford, London, England**

The arbitration rules of the International Chamber of Commerce ("ICC") are the most widely used in the world. In the 2010 International Arbitration Survey on Choices in International Arbitration,[1] 50% of respondents named the ICC as their preferred arbitration institution, followed by the London Court of International Arbitration ("LCIA") (14%) and American Arbitration Association/International Centre for Dispute Resolution ("AAA/ICDR") (8%). When asked which arbitration institution they had used most frequently over the past five years, 56% of respondents named the ICC, again followed by the LCIA and AAA/ICDR, each with 10% of the responses.

Given the popularity of the ICC Rules, there was no immediate need to revise the version in force since 1998. Nevertheless, the ICC decided to revise the 1998 Rules before it became absolutely necessary to do so. Given widespread perception that ICC arbitrations are often more expensive than arbitrations under other institutional rules, one inevitable consideration behind the revisions was to improve the speed and the cost efficiency of the arbitral process. The revisions also sought to bring the ICC Rules up to date. Some revisions were as simple as introducing gender-neutral language (e.g., "President" rather than "Chairman"),

*See "2012 ICC Rules of Arbitration," next page*

## Negotiating and Drafting an International Arbitration Clause with a Focus on Latin America: A Primer

**By Richard C. Lorenzo and María Eugenia Ramírez, Miami, Florida**

Over recent years, international commercial arbitration has gained worldwide acceptance as one of the preferred means of international dispute resolution. Recent advancement in Latin America's receptivity towards international arbitration, however, requires a new focus on the way businesses and counsel negotiate and draft the arbitration sections of their agreements. These developments warrant a fresh look into the main issues that parties should address when negotiating and drafting an arbitration clause in a transaction connected to Latin America. This article will examine the various aspects of an arbitration clause that should be understood, analyzed, and considered when negotiating and drafting an international arbitration clause in a Latin American-related transaction involving one or more U.S. parties.

### Institutional vs. Ad Hoc Arbitration

Of primary importance when drafting an arbitration provision is deciding whether the arbitration should be ad hoc (i.e., conducted without any pre-selected institutional administration or supervision) or institutional (i.e.,

*See "International Arbitration Clause," page 60*

# International Frauds and Ponzi Schemes

**By Tucker Ronzetti, Miami, Florida**

Frauds abound. Open the newspaper on a typical day, and a story appears explaining how unsuspecting investors lost millions in the latest scheme. With the advent of the internet and modern financial institutions that promote liquidity and electronic transfers, these schemes have drawn international investors and ensnared banks, accountants, law firms, and other organizations.

## Cyprus Funds

One scheme, involving Cyprus Funds, illustrates how such international frauds operate. Eric Bartoli, an apparently wealthy South American, operated Cyprus Funds and represented that he would make investments conservatively in precious metals and U.S. and Latin American companies. Investor confidence in Bartoli's abilities was bolstered by observations that he lived in a mansion and drove expensive cars. The fact that the prospectus of Cyprus Funds, ostensibly a mutual fund, listed a major U.S. bank as "custodian" gave investors further assurance. At times, Bartoli would even travel with bankers in wooing investors.

In reality, Cyprus Funds was a "Ponzi" scheme, a type of fraud where investors are repaid their own money so that the investment appears successful, and more investors are attracted and swindled. This scheme originated with Charles Ponzi, who defrauded millions in the 1920's by falsely claiming he could sell international postal coupons at 100% profit. Ponzi financed his purported business through promissory notes that he always readily repaid. The business, however, was a sham. Ponzi was paying investors with their own money, rather than paying investment returns or redemptions. The U.S. Supreme Court described Ponzi as "always insolvent, and became daily more so, the more his business succeeded. He made no investments of any kind, so that all the money he had at any time was solely the result of loans by his dupes."[1] There have been hundreds of similar schemes. While no official statistics are available, a search of a U.S. federal case database yields over 3,400 references to Ponzi.

Charles Ponzi

The Cyprus Funds Ponzi scheme victimized hundreds of investors in the U.S. and Latin America. The Latin American investors were attracted to the scheme in two ways. First, there was simple affinity to Bartoli himself, who married into a respectable and wealthy South American family. Second, and more importantly, Bartoli offered Latin American investors the safety and security of U.S. investments purportedly held in a major U.S. bank and denominated in stable U.S. dollars.

In the end, the Cyprus Funds scam imploded, as do all Ponzi schemes, when Bartoli was unable to repay investors in a timely fashion. As such schemes fail, the fraudsters use further lies to cover their tracks, and this was no exception. Bartoli falsely told investors that redemptions had to be halted to complete an accounting in connection with a sale of the fund. Of course, no genuine accounting ever occurred. Ultimately, the investors were shocked to realize that Bartoli and others had stolen over $35 million. A receivership action by the U.S. Securities and Exchange Commission, and lawsuits against those who enabled the fraud, recovered only a portion of their monies. Meanwhile, Bartoli fled to Peru, where he was later able to run yet another scheme.[2]

## InverWorld

Another international Ponzi scheme that led to financial institution liability was called InverWorld, operated out of San Antonio, Texas. InverWorld was supposedly providing banking and brokerage services to Mexican and Latin American investors who sought the security of U.S. investments. Instead, like Cyprus Funds, InverWorld was a Ponzi scheme, investing only a bit of the funds while laundering and stealing the rest.

Like the Cyprus Funds scheme, the InverWorld fraud required the assistance of banks. Millions were transferred out of InverWorld's accounts and laundered through circular transactions. Two banks involved in InverWorld's dealings learned of several red flags with regard to Inverworld, but no bank filed a suspicious activity report, and the fraud continued until the U.S. government finally stepped in. As with Cyprus Funds, the InverWorld fraud led to litigation, though investors could not recover all of their losses.

## The Nature of International Ponzi Schemes

According to the U.S. Securities and Exchange Commission, three of the most common red flags in an investment opportunity are: (1) claims of little to no risk; (2) promises of highly consistent returns; and (3) complex and opaque accounting methods.[3] In Ponzi schemes, the purported lack of risk and consistent returns lull victims into complacency. Of course, that false safety and consistency occur only because there is no underlying investment, and investors are receiving their own money. At the same time, the fraudsters use methods like arcane accounting to cover their tracks, and they operate multiple accounts and entities to transfer and launder stolen funds. Ponzi scheme operators often engage legitimate banks, accountants, attorneys, and other professionals to provide a sheen of legitimacy to the fraud.

International Ponzi schemes use these methods as well and because the investor hails from another nation, due diligence is made more difficult by cultural and language barriers. Despite those barriers, international investors find the "investments" attractive, as in the Cyprus Funds and InverWorld schemes, because they view the host nation as a stable, safe haven for their money.

The prevalence and growth of Ponzi schemes poses significant challenges for international investors, as well as international lawyers. Some modern Ponzi schemes originate in countries where authorities have few resources to detect or police sophisticated financial fraud. Even in the comparatively well-regulated United States securities market, the massive Ponzi schemes of Madoff, Stanford, and Rothstein all went undetected for years or decades. Yet Ponzi schemes are far more likely to be identified and shut down in the U.S. than they are in many other countries.

Though some international groups have made admirable efforts toward creating more forceful global deterrents to financial fraud, the perpetrators of Ponzi schemes are still governed largely by the legal systems of the nations where the schemes originated. An inconsistent patchwork of laws governs—or fails to govern—the prevention, detection, and punishment of Ponzi schemers. This raises serious concerns for foreign investors and their attorneys.

Ponzi schemes also thrive in the developing world, largely because of complex accounting.[4] Even in more developed nations such as the United States, with strong institutions and financially savvy judges and lawyers, Ponzi schemes go undetected for decades. Governments with weak financial regulations and institutions fare far worse.

Perhaps the most dramatic example is Albania. In 1997, the Albanian investment funds Sude and Gjallica collapsed. The funds were only two of a rash of purported loan and investment schemes that ultimately bilked Albanians out of about $300 million, more than half of Albania's gross domestic product at the time. Two-thirds of the population had invested in one fund or another. Soon, riots led to an estimated 2,000 deaths and the complete downfall of the Albanian government. For several months after the funds collapsed, Albania was literally a state of anarchy, with no governing institutions.

The social, economic, and political conditions of developing countries create a breeding ground for Ponzi schemes. In Albania, for example, the country's institutions had only recently been released from a half-century of stifling communist control. Albania's banks and regulators were simply incapable of identifying or stemming the rising tide of fraud. The government and media had even explicitly endorsed some of the Ponzi schemes as great investments.[5] The Albanian disaster was largely contained to Albania, but it is at least an instructive example of the conditions in which Ponzi schemes thrive and go unchecked. Where governments and regulators are weak, Ponzis flourish.

The Caribbean, in particular, has been a hotbed of Ponzi schemes in the last decade. Between 2002 and 2008, large-scale Ponzi schemes operated—and collapsed—in Antigua, Barbados, Colombia, Jamaica, Nevis, Turks and Caicos, St. Kitts, Grenada, Haiti, Dominica, and St. Lucia, among others. Jamaica was the hardest hit.[6] The collapse of the OLINT and Cash Plus schemes cost Jamaica 12% of its gross domestic product in 2008.[7]

Just prior to their collapse, Jamaica's largest Ponzi schemes had been significant players in the Jamaican government and economy. Cash Plus sponsored professional sports teams, and OLINT was heavily involved in charitable giving. Both organizations had powerful friends. When OLINT's offices were searched for evidence of fraud, a Jamaican official publicly called the search a "vulgar abuse of state power."[8]

## Insufficient International Policing of Ponzi Schemes

Ponzi scheme frauds present a double threat for the international community. First, the unique conditions of developing countries make them susceptible to Ponzi schemes. And the very same weaknesses that create favorable conditions for financial fraud also impose barriers for the foreign victims of Ponzi schemes to recover their losses. There is no standardized international legal approach to curbing securities fraud in general and Ponzi schemes in particular.[9] Instead, in most cases, the law of the country in which the Ponzi scheme was based often applies to any efforts to hold the perpetrators accountable or recover lost investments. This presents challenges to victims of international fraud.

In the United States, a well-developed body of criminal and civil law applies to Ponzi schemes. Duped investors can recover at least some of their losses by freezing and auctioning off the perpetrators' assets, either directly with bankruptcy courts or through government action like a receivership created by the Securities and Exchange Commission. Investors can also bring court cases against the perpetrators and enablers of the fraud, and those who were deceived in large numbers may be able to bring a class action. In some cases, victims have been successful in recovering their lost investments from institutions that assisted the Ponzi scheme. In the Cyprus Funds and InverWorld Ponzi frauds, for example, investors obtained recoveries from banks, accountants and others. Through liberal discovery rules in the U.S., victims uncovered evidence of the enablers' complicity in the frauds.

The same cannot be said of many countries in which Ponzi schemes thrive. The essential first move against a Ponzi scheme is to freeze the perpetrator's assets before they are laundered or hidden. In the United States, this is standard operating procedure, but the governments of many countries move more slowly, if at all. In some countries, such as Jamaica, there are no legal provisions authorizing an asset freeze. In others, such as Colombia, there are such provisions, but the burden of proof required to invoke them is so high that, from a practical perspective, all of the money will be gone by the time a court issues an order. In the case of the OLINT scheme in Jamaica, it took the Jamaican government a year to shut down the perpetrators and seize their assets.[10]

Other hurdles that Ponzi scheme victims face abroad are bureaucratic, political, legal, and technical. Many countries lack any governmental agency devoted to policing financial fraud, such as the U.S. Securities and Exchange Commission which exercises joint civil and criminal powers. In many countries, the legal structure for securities regulation requires civil and criminal authorities to work hand-in-hand to respond to financial fraud. The power of many governments to prosecute Ponzi schemes does not even stem from their securities laws. Instead, Ponzi schemes in many nations are addressed under general banking laws ill-suited to deal with large-scale financial frauds.

Compounding the problem is the fact that information-age Ponzi schemes tend to transcend national boundaries. This requires the enforcement and regulation institutions of multiple countries, operating under different political conditions and legal regimes, to work together to arrest perpetrators and freeze and redistribute their assets.

A few international organizations have made commendable efforts to harmonize the international approach to securities fraud. The International Organization of Securities Commissions has attempted to foster cooperation among securities and regulatory bodies of different countries with a multilateral "Memorandum of Understanding." This "Memorandum of Understanding" encourages nations and regulators to work together to bring perpetrators of financial fraud to justice. The Hague Securities Convention has a similar goal.[11] These initiatives are a good start, but they are non-binding and have done little to change the inconsistent patchwork of regulations governing global financial fraud. Legal and diplomatic commentators continue to deplore the current situation and recommend a stronger international approach to securities frauds.[12]

## Remedies for Victims of International Ponzi Schemes

Faced with these challenges, how can investors deal with international frauds and Ponzi schemes? Of course, the best remedy for a Ponzi scheme is prevention. That can be difficult because Ponzi schemes can take vastly different forms. Schemes have used everything from Kreuger's matchstick empire to trading in burial certificates in Kuala Lumpur. But the fundamentals are the same: Ponzi schemes attract investors by promising consistent returns, often high ones, with little to no risk. If it sounds too good to be true, then it probably is.

Victims of Ponzi schemes must often resort to governmental action, litigation, or both. The United States has become an increasingly sought-after forum for victims of international fraud because of the active plaintiffs' bar and general expertise of U.S. lawyers and judges in dealing with investment fraud. Foreign plaintiffs can often sue even foreign defendants in U.S. district courts if the defendants' actions had some substantial connection to the United States. Even in the U.S., litigation can be procedurally complex, and the courts have not been consistent in granting jurisdiction over cases involving largely foreign conduct. Victims who succeed in court may face additional hurdles, such as enforcing a U.S. judgment against a foreign defendant with no U.S. assets.[13] Despite that, victims of international Ponzi schemes with a U.S. component have consistently succeeded in recovering at least some of their losses.

As time and technology progress and the international flow of funds and information grows wider, international Ponzi schemes will no doubt multiply. Investors must be wary. When, despite that diligence, investors become victims, they must seek prudent recourse, often in nations like the U.S. that have developed institutions for their vindication.

T. Ronzetti

***Tucker Ronzetti*** *is a Florida attorney and the head of complex and commercial litigation at Kozyak Tropin & Throckmorton, P.A., in Coral Gables, Florida. His practice deals extensively with Ponzi schemes and other financial frauds.*

**Endnotes:**

1 *Cunningham v. Brown,* 265 U.S. 1, 8 (1924).

2 Kymberli Hagelburg, *Investors Say Eric Bartoli Cheated Them and Should Be Extradited to U.S.*, Plain Dealer (3 Jan. 2010), *available at* http://www.cleveland.com/business/index.ssf/2010/01/investors_say_eric_bartoli_che.html. *See also* http://www.sec.gov/investor/alerts/bartoli.htm (S.E.C. warning against Bartoli, a/k/a Enrico Orlandini).

3 U.S. Securities and Exchange Commission, *Ponzi Schemes—Frequently Asked Questions*, *available at* http://www.sec.gov/answers/ponzi.htm.

4 *See* Utpal Bhattacharya, *On the Possibility of Ponzi Schemes in Transition Economies*, Transition (World Bank), Feb. 2000 at 24-26.

5 Christopher Jarvis, *The Rise and Fall of Albania's Pyramid Schemes*, Finance & Dev. (Int'l Monetary Fund [IMF]) March 2000, Vol. 37, No. 1, *available at* http://www.imf.org/external/pubs/ft/fandd/2000/03/jarvis.htm.

6 Ana Carvajal et al., Ponzi Schemes in the Carribean (IMF Working Paper, April 2009) (*available at* http://www.imf.org/external/pubs/ft/wp/2009/wp0995.pdf).

7 Hunter Monroe, Ana Carvajal, & Catherine Pattillo, *Perils of Ponzis*, Finance & Development (IMF) March 2010, Vol. 47, No. 1, at 37, *available at* http://www.imf.org/external/pubs/ft/fandd/2010/03/monroe.htm.

8 *Id.* at 39.

9 Derek N. White, *Conduct and Effects: Reassessing the Protection of Foreign Investors from International Securities Fraud*, 22 Regent U. L. Rev. 81, 83-84 (2009-2010).

10 Carvajal, *supra* note 6; Monroe, *supra* note 7.

11 White, *supra* note 9.

12 *See id.*; Cheryl Nichols, *Addressing Inept SEC Enforcement Efforts*, 31 Nw. J. Int'l L. & Bus. 637 (Summer 2011).

13 White, *supra* note 9.