

UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF FLORIDA  
JACKSONVILLE DIVISION

In re:

LYDIA CLADEK, INC.,

Case No. 3:10-bk-02805-PMG

Debtor.

(Consolidated by Prior Court Order with Case  
No. 10-bk-02800-PMG)

**MOTION OF CHAPTER 11 TRUSTEE OF LYDIA CLADEK, INC. TO DISALLOW  
CHAPTER 11 PLAN VOTES OF RECIPIENTS OF PREFERENTIAL TRANSFERS  
AND "NET WINNER" RECIPIENTS OF FRAUDULENT CONVEYANCES**

Michael Phelan, the chapter 11 trustee (the "Trustee") of Lydia Cladek, Inc. (the "Debtor"), hereby moves (the "Motion") the Court for entry of an order, pursuant to 11 U.S.C. §§ 105(a), 502(a), 502(d) and 1126(a), to disallow the chapter 11 plan votes of all claims filed by recipients of preferential transfers who have refused to turn over such funds to the Trustee, as well as all "net winner" recipients of fraudulent conveyances. In support of the Motion, the Trustee respectfully states:

**VENUE AND JURISDICTION**

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a "core" proceeding within the meaning of 28 U.S.C. § 157(b)(2).

2. The statutory predicates for the relief requested herein are sections 105(a), 502(a), 502(d) and 1126(a) of title 11 of the United States Code (the "Bankruptcy Code"), as complemented by Rule 3007 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and paragraph 18 of this Court's *Amended Order Granting Joint Motion of Chapter 121 Trustee and Official Committee of Unsecured Creditors of Lydia Cladek, Inc. for Order (I)*

*Conditionally Approving and Combining Hearing of Amended Disclosure Statements, (II) Determining Dates, Procedures and Forms Applicable to Solicitation Process, (III) Establishing Vote Tabulation Procedures, (IV) Establishing Objection Deadline and Scheduling Hearing to Consider Confirmation of Plans, and (V) Extending Deadline to File Proofs of Claim With Respect to Certain Parties in Interest (the "Amended Solicitation Procedures Order")* [Doc. No. 388].

### **BACKGROUND**

3. On April 2, 2010 (the "Filing Date"), several petitioning creditors filed an involuntary Chapter 11 petition against the Debtor, case styled as In re Lydia Cladek, Inc., Case No. 10-bk-02800-PMG, in the United States Bankruptcy Court, Middle District of Florida, Jacksonville Division (the "Involuntary Case").

4. Subsequently, on April 5, 2010, the Debtor filed the instant voluntary Chapter 11 petition, case styled as In re Lydia Cladek, Inc., Case No. 10-bk-02805-PMG, in the United States Bankruptcy Court, Middle District of Florida, Jacksonville Division (the "Voluntary Case").

5. The Voluntary and Involuntary Chapter 11 cases of the Debtor were subsequently consolidated by Order of this Court dated April 12, 2010, and the Voluntary Case, Case No. 10-02805, was designated the lead case [Doc. No. 32].

6. By Order dated April 14, 2010, this Court approved the appointment of Michael Phelan as Chapter 11 Trustee [Doc. No. 47].

7. The Chapter 11 Trustee is currently operating the Debtor's business pursuant to sections 1106 and 1108 of the Bankruptcy Code.

8. On June 1, 2010, the Court entered a Notice of Appointment of the Committee [Doc. No. 111].

9. On October 28, 2010, the Committee filed a Disclosure Statement and Plan of Reorganization [Docket Nos. 294 – 295]. In addition, on October 28, 2010, the Committee filed a Motion to Combine Disclosure Statement and Confirmation Hearing [Doc. No. 296] (the “Motion to Combine”).

10. On November 23, 2010, the Trustee filed a Chapter 11 Plan of Liquidation and Disclosure Statement in Support of Plan of Liquidation [Doc. Nos. 347-348].

11. On December 2, 2010, the Committee filed its Amended Disclosure Statement and Amended Plan [Doc. Nos. 354 and 356].

12. On December 3, 2010, the Trustee filed its Amended Disclosure Statement and Amended Plan [Doc. Nos. 361 and 362].

13. On December 3, 2010, the Trustee and Committee filed a joint motion (the “Solicitation Procedures Motion”), pursuant to 11 U.S.C. §§ 105(a), 1125(b), and 1126(b) and Rules 2002, 3003, 3017, 3018, and 3020 of the Federal Rules of Bankruptcy Procedure, for an order (i) conditionally approving the Disclosure Statements and combining the hearing on the Disclosure Statements with the confirmation hearings on the Plans, (ii) approving the dates, procedures, and forms applicable to solicitation, noticing, and implementation process, (iii) approving vote tabulation procedures, (iv) establishing the deadline for filing objections to the Plans, (v) scheduling the hearing to consider confirmation of the Plans, (vi) approving the form of the notice of the confirmation hearings, and (vii) establishing an extended deadline to file proofs of claim with respect to certain parties in interest [Doc. No. 364].

14. On December 7, 2010, the Court entered an order approving that Solicitation Procedures Motion (the "Solicitation Procedures Order") [Doc. No. 367], which was amended by the Amended Solicitation Procedures Order on December 16, 2010. Among other things, paragraph 18 of the Amended Solicitation Procedures Order provides a procedure for disallowing the votes of claimants whose claims are subject to a pending objection filed after the voting record date. Paragraph 18 of the Amended Solicitation Order provides as follows:

Nothing in this Order affects the rights of the Trustee or the Committee (or any other party's right, if applicable) to object to any proof of claim after the Voting Record Date. With respect to any such objection, the Trustee and the Committee may request, on notice, that any vote cast by the holder of the Disputed Claim be disallowed and not counted in determining whether the requirements of 11 U.S.C. § 1126(c) have been met. In the absence of any such request, the holder of a disputed claim shall be entitled to vote in accordance with its proof of claim and/or scheduled amount, as applicable.

Amended Solicitation Procedures Order, ¶18.

15. Since being appointed, the Trustee has investigated the transfers made by the Debtor in furtherance of the Debtor's operation of a Ponzi scheme. The Trustee has identified hundreds of transfers of funds of the Debtor to Ponzi scheme investors, as well as others, including the recipients of preferential transfers and "net winners" (*i.e.*, investors who received distributions during the 4 years preceding the Filing Date (the "Fraudulent Conveyance Period") which exceeded the principal amount of their investment with the Debtor).

16. As a result of the investigation, the Trustee (i) has made demand on all recipients of preferential transfers seeking the return of any funds received within the 90 days preceding the Filing Date (the "Preference Period") and (ii) intends to commence lawsuits to avoid and recover fraudulent transfers made to "net winners" pursuant to, *inter alia*, sections 544, 548 and 550 of the Bankruptcy Code and Chapter 726 of the Florida Statutes.

17. According to the books and records of the Debtor, there are approximately 77 claimants<sup>1</sup> who received preferential transfers and have refused to return those funds to the Trustee for the benefit of all creditors. The total amount of preference claims against these recipients aggregates approximately **\$1,901,937.09**. Additionally, there are approximately 317 "net winner" investor claimants who received distributions during the Fraudulent Conveyance Period which exceeded the principal amount of their investment with the Debtor. The total amount of fraudulent conveyance claims against these "net winner" recipients aggregates approximately **\$7,266,133.89**.

18. As a result of the Debtor's operation as a Ponzi scheme, and in accordance with legal precedent discussing claims distribution in cases wherein a Ponzi scheme was found to exist, the Trustee has contemporaneously herewith filed an objection to all claims filed by recipients of preferential transfers who have refused to turn over such funds to the Trustee, as well as all "net winners" based upon 11 U.S.C. §§ 105(a) and 502(d) and the equitable principle that the claims of earlier investors should be disallowed to the extent that such investors would profit at the expense of investors who entered the scheme at a later date and received less or nothing at all from the Debtor (the "Omnibus Objection").<sup>2</sup>

### **RELIEF REQUESTED**

19. By this Motion, the Trustee respectfully requests that this Court enter an order, pursuant to 11 U.S.C. §§ 105(a), 502(a), 502(d) and 1126(a), disallowing the chapter 11 plan

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<sup>1</sup> Mary Lou Preston received \$179,570.24 during the Fraudulent Conveyance Period (\$56,810.65 of which was received during the Preference Period), which she has not returned to the estate. Ms. Preston also filed four proofs of claim in this case (Claim Nos. 942 – 945) aggregating \$108,716.52. However, Ms. Preston subsequently filed for chapter 11 protection with this Court on December 3, 2010, and therefore the Trustee has not filed an objection to her claims, nor sought to disallow her vote(s), at this time. The Trustee intends to file a proof of claim in Ms. Preston's chapter 11 case shortly.

<sup>2</sup> The Trustee has also filed a motion to authorize the Trustee to file an omnibus objection to claims (the "Objection Procedures Motion"). The Omnibus Objection and Objection Procedures Motion are incorporated herein by this reference as if fully set forth herein.

votes of recipients of preferential transfers who have refused to turn over such funds to the Trustee, as well as all "net winner" recipients of fraudulent conveyances.

20. Section 1126(a) of the Bankruptcy Code provides: "The holder of a claim or interest *allowed under section 502 of this title* may accept or reject a plan." 11 U.S.C. § 1126(a) (emphasis supplied). Section 502(a) of the Bankruptcy Code provides, in relevant part, that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, *unless a party in interest . . . objects . . .*" 11 U.S.C. § 502(a) (emphasis supplied). Thus, the holder of a claim to which a party has objected may not vote on a chapter 11 plan. *See Jacksonville Airport, Inc. v. Michkeldel, Inc.*, 434 F.3d 729, 731 (4th Cir. 2006); *In re M. Long Arabians*, 103 B.R. 211, 215 (B.A.P. 9th Cir. 1989). Paragraph 18 of the Amended Solicitation Procedures Order specifically provides that the Trustee may object to any proof of claim after the voting record date and may request, on notice, that any vote cast by the holder of a disputed claim be disallowed and not counted in determining whether the requirements of 11 U.S.C. § 1126(c) have been met. In the absence of any such request, the holder of a disputed claim would otherwise be entitled to vote in accordance with its proof of claim and/or scheduled amount, as applicable. *See* Amended Solicitation Procedures Order, ¶18.

21. Here, the Trustee has filed the Omnibus Objection to all claims filed by recipients of preferential transfers who have refused to turn over such funds to the Trustee, as well as all "net winners" pursuant to 11 U.S.C. §§ 105(a) and 502(d) and the equitable principle that the claims of earlier investors should be disallowed to the extent that such investors would profit at the expense of investors who entered the scheme at a later date and received less or nothing at all from the Debtor. Section 502(d) of the Bankruptcy Code provides:

Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is

recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522 (f), 522 (h), 544, 545, 547, 548, 549, or 724 (a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522 (i), 542, 543, 550, or 553 of this title.

11 U.S.C. § 502(d). Section 502(d) “preclude[s] entities which have received voidable transfers from sharing in the distribution of the assets of the estate unless and until the voidable transfer has been returned to the estate.” *In re Mid Atlantic Fund, Inc. (In re America West Airlines, Inc.)*, 60 B.R. 604, 609 (Bankr. S.D.N.Y. 1986); *El Paso City of Texas v. America West Airlines, Inc. (In re America West Airlines, Inc.)*, 217 F.3d 1161, 1168 (9th Cir. 2000); *Jacksonville Airport, Inc. v. Michkeldel, Inc.*, 434 F.3d at 732 (“As long as a party in interest objects to a claim – regardless of the objection’s validity or merit – the claim cannot be deemed allowed.”); *see also Inter-State National Bank of Kansas City v. Luther*, 221 F.3d 382, 389 (10th Cir. 1955) (“claims of creditors who have received or acquired void or voidable preferences are not allowable unless such creditors shall surrender such preferences”).

22. In this case, the claims listed on Exhibit A annexed hereto should be disallowed pursuant to section 502(d) of the Bankruptcy Code because those claimants are recipients of preferential transfers who have refused to turn over such funds to the Trustee. In addition, the claims listed on Exhibit B annexed hereto should be disallowed pursuant to 11 U.S.C. § 502(d) and equitable principles<sup>3</sup> because these “net winner” investors received a full return of their principal as well as some “profit,” which consisted, in reality, of other customers' investments. *See In re Bernard L. Madoff Inv. Securities LLC*, 424 B.R. 122, 132 (Bankr. S.D.N.Y. 2010); *see*

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<sup>3</sup> “[T]he overriding consideration in bankruptcy ... is that equitable principles govern”, *see In re NWFEX, Inc.*, 864 F.2d 588, 590 (8th Cir. 1988), and bankruptcy courts have broad equitable powers to order relief pursuant to section 105(a) of the Bankruptcy Code. *See, e.g., River Hills Assocs., Ltd. v. River Hills Apartments Fund (In re River Hills Apartments Fund)*, 813 F.2d 702, 707 (5th Cir. 1987); 11 U.S.C. § 105(a) (providing that the Court “may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title.”).

*also Donell v. Kowell*, 533 F.3d 762, 770-71 (9th Cir. 2008) (holding that transfers to “net winners” pursuant to a Ponzi scheme are both actually and constructively fraudulent).<sup>4</sup>

23. Based on the foregoing statutory law, equitable principles and established Ponzi scheme jurisprudence, the Trustee requests that the Court disallow the chapter 11 plan votes of all recipients of preferential transfers who have refused to return those funds to the Trustee, as well as all “net winner” recipients of fraudulent conveyances pursuant to sections 105(a), 502(a), 502(d) and 1126(a) of the Bankruptcy Code.

### **RESERVATION OF RIGHTS**

24. Nothing set forth herein is intended, nor shall be deemed, to modify, limit, release, reduce, or waive any of the Trustee's or the estate's rights, claims, remedies, causes of action, or privileges at law or in equity, all of which are specifically preserved. More specifically, but not limiting the foregoing, nothing contained in this Motion shall be construed as a waiver of any rights that the Trustee may have (i) to bring avoidance actions under the applicable sections of the Bankruptcy Code or applicable law, including, but not limited to, sections 547, 548 and 550 of the Bankruptcy Code and Chapter 726 of the Florida Statutes, against the holders of claims subject to the Omnibus Objection, or (ii) to exercise the Debtor's right of setoff against the holders of such claims relating to such avoidance actions.

### **CONCLUSION**

WHEREFORE, Michael Phelan, the Chapter 11 Trustee of the consolidated Chapter 11 cases of the Debtor, respectfully requests that the Court (i) grant the Motion, (ii) disallow the chapter 11 plan votes of the claimants subject to the Omnibus Objection, and (iii) grant the Trustee such other and further relief as this Court deems just and proper.

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<sup>4</sup> The “clawback” jurisprudence that has developed in Ponzi scheme cases -- both in and outside of bankruptcy -- is designed to equalize the winners and losers, by recovering false profits from the net winners who typically invested early in the Ponzi scheme and distributing such recoveries to the net losers who typically invested later.

Respectfully submitted this 18th day of January, 2011.

**BRENNAN, MANNA & DIAMOND, P.L.**

By /s/ Robert Wilcox

Robert D. Wilcox

Florida Bar Number 755168

Alessandro A. Apolito

Florida Bar Number 0084864

800 West Monroe Street

Jacksonville, Florida 32202

(904) 366-1500 (Telephone)

(904) 366-1501 (Facsimile)

Attorneys for Michael Phelan,  
as Chapter 11 Trustee

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a copy of the foregoing was furnished either by electronic notification or U.S. Mail, postage prepaid and properly addressed, this 18th day of January, 2011, to all parties on the attached Amended Official Service List and all parties listed on Exhibits A and B to the annexed Motion.

/s/ Robert Wilcox  
Attorney

Lydia Cladek, Inc.  
Case No.: 3:10-bk-2805-PMG  
**Preferential Transfers**

Bennett Yell Agency, Inc.  
9075 June Lane  
St. Augustine, FL 32080

Susan Pell-Mandeville  
Charles A. Mandeville  
56 Fairway View  
Peterstown Way, WV 24963

Rogers Towers, P.A.  
c/o J. Ellsworth Summers, Jr., Esq.  
1301 Riverplace Blvd., Suite 1500  
Jacksonville, FL 32207

Robert Mengarelli  
1397 Fryston St.  
St. Johns, FL 32259

National Financial Services, LLC  
FBO: Bruce Hall  
200 Liberty St., 5th Floor  
New York, NY 10281

# **Exhibit A**

**Preferential Transfers**

<u>Payee</u>	<u>Total</u>	<u>Notes</u>	<u>Proof of Claim #</u>	<u>Unsecured</u>	<u>Priority</u>
Bennett Yell Agency, Inc.	\$ 39,135.92	Investor Interest and Withdrawals	620	\$1,040,883.00	
Bennett Yell Agency, Inc.			1028		\$1,000.00
Charles A. or Susan Mandeville	\$ 20,287.50	Investor Interest and Withdrawals	357	\$400,000.00	
Charles A. or Susan Mandeville			358	\$861,089.45	
National Financial Services, LLC, FBO: Bruce Hall	\$ 14,000.00	Investor Interest and Withdrawals	471	\$714,905.10	
Rogers Towers	\$ 15,000.00	Legal Expense	320	\$47,499.73	
Susan H. or Charles Mandeville	\$ 9,007.45	Investor Interest and Withdrawals		See Above	See above
Robert Mengarelli	\$ 6,380.58	Investor Interest and Withdrawals	819	\$88,355.32	\$1,000.00

# **Exhibit B**

## "Net Winners"

Last Name	First Name	Claim Number	Proof of Claim Amount	Scheduled Amount	Net Winner Amount
Fleming Mandeville	Julie	no claim		\$ 52,946.37	16,441.92
C.A.T.S.		283	\$ 25,500.00	\$ 24,954.18	74.70