

Disclaimer: we are not providing any legal advice nor is this an opinion on whether there's legal basis for clawbacks claims surrounding FTX related grants.

What is a clawback?

A clawback is where a debtor¹ (i.e. the person filing for bankruptcy) seeks to undo a transaction and get the money back so that the bankruptcy estate can pay the claims of its creditors. In certain situations, a debtor may seek to claw back charitable gifts a donor has made as part of the debtor's bankruptcy case. In this context, clawback claims might be made against the grantee or any subsequent recipients, including subgrantees, or subcontractors.

How does a clawback action work?

The most common clawback action occurs when the debtor files a complaint, making a "preference demand" or a "fraudulent conveyance" claim.

A preference demand is for the return of payments in the 90 days before a bankruptcy and prevents a debtor who is aware they might be going into bankruptcy from "preferring" a given creditor.

Fraudulent conveyances can involve *actual* fraud which are transfers made with intent to defraud. They can also involve *constructive* fraud which would be transfers for less than "reasonably equivalent" value when the debtor was insolvent or when the transfer resulted in insolvency (with "reasonably equivalent" value being the bankruptcy law measure for whether or not the company got enough in return for the transfer – vaguely akin to the concept of fair market value). We are still reviewing how fraudulent conveyances work in the charitable or social welfare context.

Note that a claim asserted by a debtor that a transfer was a fraudulent conveyance does not necessarily mean that the *recipient* has done anything wrong -- this type of claim can be made, and can be successful, even where the recipient is "innocent" and had no underlying knowledge. So if a debtor makes a grant to a grantee and the grantee had no idea that the debtor was doing something questionable, it could still be a fraudulent conveyance.

How far back in time can clawbacks go?

Under the Bankruptcy Code, the "look back" period for avoiding transfers is two years. However, some state laws extend this period. This means that while there is particular scrutiny on transfers made in the two years before bankruptcy, the debtor may seek to avoid transfers that occurred even further than just two years before the bankruptcy.

A debtor also usually has two years before it must decide whether to file clawback actions. Given the complexity of a large bankruptcy case (including the number of transactions at issue),

¹ In this paper, the word debtor almost always means the debtor or its bankruptcy trustee.

this means that it can be some period of time after a bankruptcy is filed before the debtor determines who to bring claims against.

How do people get notified that they're subject to a clawback action?

A debtor (or its bankruptcy trustee) often sends the defendant(s) a demand letter before they commence the clawback action. However, the debtor/bankruptcy trustee is not required to send a demand letter, and they can simply file a complaint as part of the bankruptcy, seeking to "avoid" (undo) the transfer and receive a return of the funds.

Once a complaint is filed, then it becomes like a typical litigation, meaning the defendant(s) (for example, a grantee and anyone they passed the funds on to, including subgrantees and contractors) must decide how to respond. The defendant may be able to assert exceptions, limitations and defenses depending on the facts of the case that would allow them to defeat the clawback action. If the defendant does not respond (even if there are "good" facts that it was not a fraudulent conveyance), then the court will likely issue a default judgment against the defendant and they may be liable for the amounts claimed. Some of these litigations occur quickly and others drag on for many years .

If a transfer (including a grant or subgrant) is determined to be a "fraudulent conveyance" under the bankruptcy rules, and none of the potential exceptions or defenses apply, the typical remedy is for the transfer to be "avoided" and the recipient (or the subrecipient) to have to return the transfer to the bankruptcy estate.

Is interest applied to clawbacks?

Courts have significant discretion in awarding interest on avoidance actions, and its fact specific, on whether the court will grant interest, when interest will begin to accrue, what interest rate will apply. If interest is applied to the judgment, courts typically hold it applies from the date of either when the bankruptcy was filed or from the date the clawback action was filed, however, some courts have also applied interest going back to the date of the initial transfer, though that is rare.

What about non-US recipients?

The debtor could bring an avoidance action in the US against a non-US recipient. The recipient would then have to decide whether to litigate in the US. It could file a motion that the bankruptcy court lacks personal jurisdiction over it. The debtor could then seek to seize its assets if it had any in the US, or haul into court in US if has a hook for jurisdiction, or if it had no assets in the US/ no jurisdiction, then there would be a question of whether the foreign court would let the debtor pursue the default judgment in that court. This takes substantial legal resources, so would only be worth it for larger sums.

Usually foreign defendants are concerned about having a default judgment so they do not take that route and rather argue as part of a motion to dismiss in the US case that the court lacks jurisdiction over it. But whether a defendant decides to appear in the US court and dispute jurisdiction or rather do nothing and get a default judgment and then litigate in the foreign

court when the debtor seeks to collect on the judgment often is a function of the specifics of the defendants' jurisdiction arguments and also the applicable law of the home country.