

Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

JULY/AUGUST 2016

EDITOR'S NOTE: QUESTIONS ANSWERED

Victoria Prussen Spears

TEXAS SUPREME COURT RESOLVES FRAUDULENT TRANSFER VALUE DEFENSE FOR FIFTH CIRCUIT

Michael L. Cook

BANKRUPTCY REMOTE SPECIAL PURPOSE ENTITIES ARE NOT NECESSARILY BANKRUPTCY PROOF

Peter C. Blain

NINTH CIRCUIT REMINDS US OF LIMITS TO BANKRUPTCY JURISDICTION

Prashant M. Rai

THE PROBLEM WITH *CHERWENKA*

David Randall Jenkins

TIMING IS EVERYTHING — *FRENVILLE* CONTINUES TO SURFACE IN PRE-2011 CASES

Kevin Bostel

FOUR CONSIDERATIONS FOR MECHANIC'S LIENS ON ALTERNATIVE ENERGY PROJECTS

Matthew C. Olsen and Peter C. Halls

THE EFFICIENT MARKET HYPOTHESIS APPLIES IN THE TRAFFICKING OF CLAIMS AND SETTLEMENT OF CIVIL LAWSUITS IN BANKRUPTCY

David J. Cook



LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D. at 415-908-3207

Email: kent.hanson@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at (800) 833-9844

Outside the United States and Canada, please call (518) 487-3000

Fax Number (518) 487-3584

Customer Service Web site <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or (800) 223-1940

Outside the United States and Canada, please call (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [article title], [vol. no.] PRATT’S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the “Rescue and Recovery” Culture for Business Recovery*, 10 PRATT’S JOURNAL OF BANKRUPTCY LAW 349 (2014)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a registered trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2016 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW  BENDER

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF

STEVEN A. MEYEROWITZ

President, Meyerowitz Communications Inc.

EDITOR

VICTORIA PRUSSEN SPEARS

Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena

*Bilzin Sumberg Baena
Price & Axelrod LLP*

Thomas W. Coffey

Tucker Ellis & West LLP

Robin E. Keller

Lovells

Leslie A. Berkoff

*Moritt Hock & Hamroff
LLP*

Michael L. Cook

Schulte Roth & Zabel LLP

Matthew W. Levin

Alston & Bird LLP

Ted A. Berkowitz

Farrell Fritz, P.C.

Mark G. Douglas

Jones Day

Patrick E. Mears

Barnes & Thornburg LLP

Andrew P. Brozman

Clifford Chance US LLP

Timothy P. Duggan

Stark & Stark

Alec P. Ostrow

Stevens & Lee P.C.

Kevin H. Buraks

*Portnoff Law Associates,
Ltd.*

Gregg M. Ficks

*Coblentz, Patch, Duffy &
Bass LLP*

Deryck A. Palmer

*Pillsbury Winthrop Shaw
Pittman LLP*

Peter S. Clark II

Reed Smith LLP

Mark J. Friedman

DLA Piper

N. Theodore Zink, Jr.

Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc. Copyright 2016 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844.

Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz,

Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 630 Central Avenue, New Providence, NJ 07974.

Texas Supreme Court Resolves Fraudulent Transfer Value Defense for Fifth Circuit

*By Michael L. Cook**

This article discusses a recent decision by the Texas Supreme Court addressing a certified question from the U.S. Court of Appeals for the Fifth Circuit pertaining to the fraudulent transfer value defense.

“Reasonably equivalent value” as a defense to a fraudulent transfer suit “can be satisfied with evidence that the transferee (1) fully performed under a lawful, arm’s-length contract for fair market value, (2) provided consideration that had objective value at the time of the transaction, and (3) made the exchange in the ordinary course of the transferee’s business,” held the Supreme Court of Texas on April 1, 2016, in response to a certified question from the U.S. Court of Appeals for the Fifth Circuit.¹ The Fifth Circuit, on March 11, 2015, had initially held an advertising firm in a Securities and Exchange Commission receiver’s Texas fraudulent transfer suit liable for \$5.9 million it had received in good faith from a Ponzi scheme debtor.²

BACKGROUND

The district court had earlier dismissed the receiver’s complaint, relying on the defendant’s statutory “affirmative defense that it received the payments in good faith and in exchange for reasonably equivalent value (the market value of advertising on the Golf Channel),” reasoning that the defendant “looks more like an innocent trade creditor than a salesman perpetrating and extending the [debtor’s] Ponzi scheme.” On rehearing, the Fifth Circuit in *Golf Channel II* vacated its earlier opinion and asked the Texas Supreme Court “what showing of ‘value’ under [the Texas version of the Uniform Fraudulent Transfer Act (“TUFTA”)] is sufficient for a transferee to prove . . . the [good-faith]

* Michael L. Cook, of counsel at Schulte Roth & Zabel LLP and a member of the Board of Editors of *Pratt’s Journal of Bankruptcy Law*, has served as a partner in the firm’s New York office for 16 years, devoting his practice to business reorganization and creditors’ rights litigation, including mediation and arbitration. He may be contacted at michael.cook@srz.com.

¹ *Janvey v. Golf Channel*, ___ S.W.3d ___, 2016 Tex. LEXIS 241, at *7 (Tex. Apr. 1, 2016), responding to *Janvey v. Golf Channel Inc.*, 792 F.3d 539, 547 (5th Cir. 2015) (“*Golf Channel I*”).

² *Janvey v. Golf Channel Inc.*, 780 F.3d 641, 646–47 (5th Cir. 2015) (“*Golf Channel I*”) (advertising services had “no value” to Ponzi scheme creditors although services might be “quite valuable” to creditors of a legitimate business).

affirmative defense under . . . [TUFTA].”³

RELEVANCE

The Fifth Circuit’s initial decision in *Golf Channel I* had offered no practical guidance as to whether a truly innocent service provider such as a utility, dentist or plumber would be subject to its draconian holding. Although conceding that its holding might have been different had the debtor been engaged in a legitimate business, the Fifth Circuit stressed that this case “is different because [the debtor] was engaged in a Ponzi scheme.” Other courts in this context had approached the issue differently.⁴

The Fifth Circuit had earlier noted that the “good faith” defense contained in Bankruptcy Code Section 548(c), similar to UFTA § 8(a) and TUFTA § 24.009(a), was meant to “protect . . . the [good-faith] transferee from his unfortunate selection of business partners.”⁵ Its *Golf Channel I* holding, however, was inconsistent with *Hannover*. Fortunately, the receiver in *Golf Channel* sued under TUFTA, which specifically defines “reasonably equivalent value” to include “consideration having value from a marketplace perspective,” a definition that “has no parallel in UFTA or in any other state’s uniform fraudulent transfer statute.”⁶ For that reason, the Fifth Circuit asked the Texas court to resolve the statutory “tension” on how “to measure ‘reasonably equivalent value.’”⁷ Assuming that the parties exchanged value, the Texas Supreme Court asked whether “the debtor received a fair exchange in the market place for the [asset] transferred.”⁸

³ 2016 Tex. LEXIS 241, at *6.

⁴ *In re Churchill Mortgage Inv. Corp.*, 264 B.R. 303, 308 (S.D.N.Y. 2001) (affirming bankruptcy court, held debtors “received ‘value’ in exchange for the commissions paid to the Brokers for performing in good faith a facially lawful and customary service There is neither an allegation of the Brokers’ knowledge of the Ponzi scheme nor of an unreasonably high or excessive commission paid to the Brokers.”); *In re Universal Clearing House Co.*, 60 B.R. 985, 999 (D. Utah 1986) (reversing bankruptcy court, held Ponzi scheme debtor’s “sales agents’ . . . services . . . fall . . . squarely within the definition of value in [Section 548] [W]e do not think that the goods and services [provided by the debtor’s landlord, salaried employees, accountants and attorneys, and utility companies] were without value or their transfers to them could be set aside as fraudulent [transfers] The financial position of the debtor need not necessarily be improved by a particular transaction in order for us to hold that value was given.”).

⁵ *In re Hannover Corp.*, 310 F.3d 796, 802 (5th Cir. 2002).

⁶ 2016 Tex. LEXIS 241, at *19.

⁷ 792 F.3d at 547.

⁸ 2016 Tex. LEXIS 241, at *21, quoting *In re Ozark Rest. Equip. Co.*, 850 F.2d 342, 344–45 (8th Cir. 1988).

ANALYSIS

Value

First, reasoned the court, “the services Golf Channel provided indisputably had objective value at the time of the transaction, even if [the debtor] was insolvent or imminently insolvent at the time. Certainly, had [the debtor] not purchased Golf Channel’s television airtime, the services would have been available to another buyer at market rates.”⁹

Statutory Purpose and General Principles

The court followed the direction of the Texas legislature that TUFTA be “applied and construed to effectuate its general purpose to make uniform the law with respect to [fraudulent transfers] among states enacting [the model UFTA].”¹⁰ Not only had the legislature “adopted UFTA’s definition of ‘value,’ ” but that definition “is based on section 548(d)(ii)(A) of the Bankruptcy Code.”¹¹ Moreover, “courts interpreting UFTA-based statutes consider analogous bankruptcy authority to be instructive of the proper meaning and application of that term and the related concept of reasonably equivalent value.”¹² The court was therefore comfortable in considering other courts’ “construction [of] the pertinent terms in cases applying section 548 of the Bankruptcy Code and similar provisions in UFTA statutes enacted by other states,” plus “comments accompanying the model law.”¹³

Complete Defense

Both TUFTA and the model Act protect transferees like Golf Channel “who took in good faith and for a reasonably equivalent value” by providing “a *complete defense* although the debtor is shown to have intended to hinder, delay or defraud creditors.”¹⁴ But TUFTA “is unique among uniform fraudulent-transfer laws because it provides a specific market-value definition of ‘reasonably equivalent value.’ ”¹⁵ Still, said the court, construing the term “value” so as to “automatically or effectively exclude consideration in the form of consumable goods or services—for example, food, utilities, internet or telephone services,

⁹ *Id.* at *22.

¹⁰ *Id.* at *29.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at *30.

¹⁴ *Id.* at *31 (emphasis in original).

¹⁵ *Id.* at *32.

office supplies, and employee compensation or benefits—is simply unsupportable under a plain reading of [TUFTA].”¹⁶ Even when the debtor’s “payment for the services depleted estate assets and merely offset the liability that arose when the debtor incurred the obligation to pay for the services or goods in the first instance,” the debtor still “received value.”¹⁷ Indeed, said the court, “the definition of value expressly includes a transfer made to satisfy an antecedent debt even though satisfaction of the debt would deplete estate assets that might otherwise have been available for the benefit of creditors.”¹⁸ Although “UFTA’s comments prescribe a creditor’s viewpoint as to the utility of consideration, it does not impose a subjective value inquiry nor countenance a retrospective one,” and “[n]either does TUFTA.” Simply stated, TUFTA “does not support a distinction based on the type of consideration exchanged, particularly when such a distinction would “effectively negate a transferee’s good faith defense in certain categories and transactions—namely intangible services and consumable goods.”¹⁹

Under the court’s plain reading of TUFTA, “value exists when the debtor took consideration that had objective value at the time of the transfer, even if the consideration neither preserved the debtor’s estate nor generated an asset or benefit that could be levied to satisfy unsecured creditors.”²⁰ In sum, the court reasoned, the “reasonably equivalent value requirement in [TUFTA] is thus satisfied if a transferee performs objectively valuable services or transfers goods in an arm’s-length transaction at market-value rates.”²¹

Value Is Value Even in a Ponzi Scheme

The court also rejected the receiver’s argument that consideration provided to a Ponzi scheme debtor can never constitute “value” or “reasonably equivalent

¹⁶ *Id.* at *38.

¹⁷ *Id.* at *39, citing *In re Richards & Conover Steel Co.*, 267 B.R. 602, 612 (B.A.P. 8th Cir. 2001), quoting 2 Epstein, Nickels & White, *Bankruptcy* § 6-49, at 23 (1992); 5 Collier, *Bankruptcy* ¶ 548.05[2][a] (value received by debtor need not be something “on which creditors can levy; . . . with respect to valuable services, such as legal or other similar professional services, courts will not factor in a lack of tangible increase in physical assets,” but courts will discount “intangible and transitory assets and rights that have value only to the debtor”).

¹⁸ *Id.* at *40, citing Tex. Bus. & Com. Code § 24.004(a).

¹⁹ *Id.* at 41.

²⁰ *Id.* at *42, citing *In re RML, Inc.*, 92 F.3d 139, 149 (3d Cir. 1996) (value exchanged when debtor obtains benefit from services performed, such as cleaning windows, received in exchange for payment to a window-washer); *In re Chomakos*, 69 F.3d 769, 771 (6th Cir. 1995) (chance of winning bet placed at casino constituted value at time bet was placed).

²¹ *Id.*

value.”²² It specifically relied on *In re Fin. Federated Title & Trust, Inc.*²³ In that case, the U.S. Court of Appeals for the Eleventh Circuit “dismissed the logic of cases in which courts had held that value is lacking as a matter of law in compensation transactions involving a Ponzi scheme.”²⁴ According to the Eleventh Circuit, “negating value based on the nature of the debtor’s enterprise would improperly conflate the independent statutory inquiries of value, insolvency, and good faith. Value is value regardless of whether the debtor is insolvent or whether either party is acting in good faith.”²⁵

Other State Courts

The Texas Supreme Court relied on the “only . . . state high court” decision that “has addressed the Ponzi-scheme presumptions and good-faith defense under an UFTA-based statute.”²⁶ Construing the Minnesota Uniform Fraudulent Transfer Act, the Minnesota Supreme Court declined to apply Ponzi-scheme presumptions but instead relied on a case-specific inquiry.²⁷ According to that court, “if it were to presume the transfers from Ponzi-scheme operators were not for value, it would ‘effectively negate a transferee’s good-faith defense to an actual-fraud claim.’”²⁸ Like the Minnesota Supreme Court, the Texas court “refused to apply the statute in a way that would nullify a statutory affirmative defense whenever the debtor was operating a Ponzi scheme.”²⁹

Applying Law to Facts

Conducting “the same ‘value’ and ‘reasonably equivalent value’ analysis inquiry under TUFTA regardless of whether the debtor was operating a Ponzi scheme or legitimate enterprise,” the Texas Supreme Court focused on “whether the debtor received value . . . and whether the value exchanged was reasonably equivalent.”³⁰ Applying this analysis, the court found “Golf Channel’s media-advertising services [to have] objective value and utility from a reasonable creditor’s perspective at the time of the transaction, regardless of [the debtor’s]

²² *Id.* at *54.

²³ 309 F.3d 1325, 1332 (11th Cir. 2002) (evaluation of whether an employee of a Ponzi scheme debtor provided value “should focus on the value of the goods and services provided rather than on the impact that the goods and services had on the bankrupt enterprise”).

²⁴ 2016 Tex. LEXIS 241, at *48.

²⁵ *Id.* at *50, citing 309 F.3d at 1331–32.

²⁶ *Id.* at *52.

²⁷ *Finn v. Alliance Bank*, 860 N.W.2d 638, 647 (Minn. 2015).

²⁸ 2016 Tex. LEXIS 241, at *53, quoting 860 N.W.2d at 649.

²⁹ *Id.*

³⁰ *Id.* at *54.

financial solvency at the time. In exchange for its payments, [the debtor] received not merely speculative, emotional consideration, but accepted full performance of services with objective, economic value that were provided in the ordinary course of Golf Channel's business Moreover, as services were fully provided, each payment also had value under TUFTA by extinguishing claims against the [debtor's] estate for the value of those services."³¹ Indeed, the district court in *Golf Channel* "determined that [the defendant] provided its services at full market value in an arm's-length transaction, and the Receiver did not challenge that ruling on appeal."³²

Finally, held the court, "TUFTA does not contain separate standards for accessing 'value' and 'reasonably equivalent value' based on whether the debtor was operating a Ponzi scheme. . . . Value must be determined objectively at the time of the transfer and in relation to the individual exchange at hand rather than viewed in the context of the debtor's enterprise."³³

COMMENT

The Fifth Circuit will now have to affirm the district court's dismissal of the receiver's complaint as a matter of Texas law. "The facts are undisputed," and "the parties [had] filed cross-motions for summary judgment."³⁴ Thanks to the Texas Supreme Court, Golf Channel will be protected from its "unfortunate selection of [a] business partner."³⁵

³¹ *Id.* at *56.

³² *Id.* at *57.

³³ *Id.* at *57–58.

³⁴ *Golf Channel I*, 780 F.3d at 642–43.

³⁵ See *In re Hannover Corp.*, 310 F.3d at 802.