

Alert

Fifth Circuit Again Limits Meaning of “Value” in Creditors’ Good Faith Fraudulent Transfer Defense

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The U.S. Court of Appeals for the Fifth Circuit, on March 11, 2015, held an advertising firm in an SEC receiver’s Texas fraudulent transfer suit liable for \$5.9 million that it received in good faith from a Ponzi scheme¹ debtor. *Janvey v. The Golf Channel, Inc.*, 2015 WL 1058022, at *1 (5th Cir. March 11, 2015). In reversing the district court, the Fifth Circuit explained that the defendant’s “services furthering a debtor’s Ponzi scheme provide no value to the debtor’s creditors.” *Id.* (citing *Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006) (held, commissions paid to broker in exchange for obtaining new investments into a Ponzi scheme are voidable even when broker unaware of fraud)). The lower court had 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).” It reasoned that the defendant “looks more like an innocent trade creditor than a salesman perpetrating and extending the [debtor’s] Ponzi scheme.” *Id.* at *2. Unfortunately, the Fifth Circuit 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.

Relevance of the Case

The debtor in *Golf Channel*, the convicted operator of a Ponzi scheme, made payments to the transferee with actual intent to hinder, delay or defraud its creditors,² but the transferee had admittedly received the payments in good faith. According to the Fifth Circuit, however, the good faith transferee “put forward no evidence that its services preserved the value of [the debtor’s] estate or had any utility from the creditors’ perspective [T]he market value of its services ... was insufficient to satisfy its burden under [the Texas Uniform Fraudulent Transfer Act (“TUFTA”)] of proving value to the creditors.” *Id.* at *4 (emphasis in original).

The court thus rejected the debtor’s receipt of “market value” services as a defense. It stressed the need for creditors of the Ponzi scheme debtor to receive value in exchange for the debtor’s cash payment. *Id.* at *4. Just five months earlier, another panel of the same court had held that a good faith transferee from a legitimate debtor gave “value” only to the extent it provided the debtor with office space having a “market rent” value of \$253,000, based on an appraisal of reasonable rental value. *In re Positive*

¹ “A ‘Ponzi scheme’ typically describes a pyramid scheme where earlier investors are paid from the investments of more recent investors, rather than from any underlying business concern, until the scheme ceases to attract new investors and the pyramid collapses.” *Eberhard v. Marcu*, 530 F.3d 122, 132 n.7 (2d Cir. 2008).

² “In [the Fifth] Circuit, proving that [a debtor/transferor] operated as a Ponzi scheme establishes the fraudulent intent behind the transfers it made.” *Janvey v. Brown*, 767 F.3d 430, 439 (5th Cir. 2014).

Health Management, 769 F.3d 899, 909 (5th Cir. 2014). That decision turned on “the value that the transferee [defendant] gave up as its side of the bargain” but disregarded evidence of other indirect economic benefits received by the debtor. *Id.* at 904-05.³

Facts

The Ponzi scheme debtor in *Golf Channel* was the subject of an SEC receivership in a Texas federal court. The court-appointed receiver had taken “custody of any and all assets owned by or traceable to the receivership estate, which included recovering any voidable transfers made by [the Ponzi scheme debtor] before going into receivership.” 2015 WL 1058022, at *1. The Golf Channel had broadcast golf tournaments that had been sponsored by the debtor. It had entered into an arms’-length agreement with the debtor for “an advertising package [and] a range of marketing services including ... commercial airtime ... ; messaging regarding [the debtor’s] charitable contributions, products, and brand;” plus other related advertising services. As noted, the debtor “had paid at least \$5.9 million to Golf Channel” under this agreement. *Id.*

The Litigation

After the receiver sued Golf Channel under the Texas version of the Uniform Fraudulent Transfer Act (“UFTA”), the parties cross-moved for summary judgment because there was apparently no material fact issue. They also stipulated that the “\$5.9 million transfer to Golf Channel was fraudulent” because it was undisputed that the debtor had been “engaged in a Ponzi scheme.” *Id.* at *3. Like Bankruptcy Code Section 548(a)(1), TUFTA provides that a transfer is fraudulent if made “with actual intent to hinder, delay or defraud any creditor of the debtor.” *Id.* at *2.

Golf Channel relied upon the affirmative defense contained in TUFTA: When a transfer is fraudulent with actual intent, as was the case here, the transferee will not be liable if it “took in good faith and for a reasonably equivalent value” Because Golf Channel’s good faith was admitted, the only issue was whether its “advertising services provided ‘reasonably equivalent value’ as defined under TUFTA.” *Id.* at *3. According to the court, “whether the property or service exchanged categorically had any value under TUFTA ... is a question of law.” *Id.* (citing *Warfield*, 436 F.3d at 558 (held, broker services furthering a Ponzi scheme have no value as a matter of law) and *In re Fruehauf Trailer Corp.*, 444 F.3d 203, 212-13 (3d Cir. 2006) (referring to “ ... the threshold question of whether any value was received at all”)).

TUFTA defines value as “property ... or [the securing of or satisfaction of] an antecedent debt.” To construe this part of the statute, the court relied on “the comments to UFTA, authorities interpreting other states’ UFTA provisions, and interpretations of section 548 of the Bankruptcy Code (upon which UFTA’s definition of value is based).” 2015 WL 1058022, at *3. In its view, “courts are left to define the contours of ‘value’ and [t]he primary consideration ... is the degree to which the transferor’s net worth is preserved.” *Id.* at *4 (quoting *Warfield*, 436 F.3d at 558). As the court explained, “we measure value ‘from the standpoint of the creditors,’ not from that of a buyer in the marketplace.” *Id.*

Analysis

According to the Fifth Circuit, Golf Channel’s mere showing of the market value of its services failed as a matter of law. Because “Golf Channel’s (unknowing) efforts to extend [the debtor’s] scheme had no

³ For more information, see our Dec. 1, 2014 *Alert*, “[Fifth Circuit Narrows Meaning of ‘Value’ in Good Faith Lender’s Fraudulent Transfer Defense.](#)”

value to the creditors,” its services to the debtor “encourage[d] investment in” the Ponzi scheme. Its “services may have been quite valuable to the creditors of a legitimate business” but had “no value to the creditors of a Ponzi scheme.” *Id.* at *4.

Golf Channel tried to distinguish itself from the broker in the *Warfield* case, claiming that “an advertiser is an innocent ‘trade creditor’ generally promoting a business’s brand.” But the court rejected any “distinction between different types of services or different types of transferees,” focusing instead on “the value of any services from the creditors’ perspective,” making no “exception for ‘trade creditors.’” *Id.* at *5.

The court admitted “that [Golf Channel’s] advertising services themselves (may have had) value in the abstract.” It stressed, however, that “the advertising services did not provide even a speculative economic benefit to [the debtor’s] creditors.” *Id.* It also stressed that the debtor “was engaged in a Ponzi scheme, not a legitimate enterprise,” explaining that the “issue is not whether Golf Channel’s services have value in the abstract, but whether they provided reasonably equivalent value to [the debtor’s] creditors.” *Id.* at *5 n.9.

Comments

- The court conceded that its holding might have been different had the debtor been engaged in a legitimate business. “[W]e have held that a debtor purchasing jet fuel to keep an affiliated airline in business is an exchange for reasonably equivalent value even though the value to the debtor is merely the potential proceeds of a possible sale of that affiliated airline.” *Id.* at *5 (citing *In re Fairchild*, 6 F.3d 1119, 1123-27 (5th Cir. 1993)). Other circuits have agreed with that analysis for legitimate businesses. *In re Morris Commc’ns NC, Inc.*, 914 F.2d 458, 466, 474-75 (4th Cir. 1990) (held, ownership in company whose only asset was a remote chance of winning a cellular license in an FCC lottery had value); *In re R.M.L., Inc.*, 92 F.3d 139, 152-53 (3d Cir. 1996) (held, commitment letter with only small chance of maturing into financing had value). As the Fifth Circuit stressed, though, *Golf Channel* “is different because [the debtor] was engaged in a Ponzi scheme” 2015 WL 1058022, at *5 n.9.
- Some lower courts in the Ponzi scheme context have previously rejected the Fifth Circuit’s analysis. *In re Churchill Mortgage Inv. Corp.*, 256 B.R. 664, 680 (Bankr. S.D.N.Y. 2000) (dismissing fraudulent transfer claims “as a matter of law ... [b]rokers ... were hired and paid to produce mortgages or investors [for Ponzi scheme debtor]. They produced and ... gave value, giving rise to a contractual obligation on the part of [the debtor] to pay the commissions They earned what they were paid fairly and without wrongdoing [T]hat ... these transactions may be said to ‘exacerbate the harm to creditors and diminish the debtor’s estate’ from an overall perspective does not mean the debtor received less than reasonably equivalent value ...”), *aff’d*, 264 B.R. 303, 308 (S.D.N.Y. 2001) (“The 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 Broker’s 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 debtors’ landlord, salaried employees, accountants and attorneys, and utility companies] were without value or that transfers to them could be set aside as fraudulent [transfers] The financial position of a

debtor need not necessarily be improved by a particular transaction in order for us to hold that value was given”).

- The Fifth Circuit’s recent provocative decisions on “value” in the fraudulent transfer context — *Golf Channel* and *Positive Health* — show apparent inconsistencies among Bankruptcy Code 11 U.S.C. Sections 101 et seq., the Uniform Fraudulent Transfer Act (adapted by 43 states, the District of Columbia and the U.S. Virgin Islands) and case law interpreting these statutes. At the very least, these recent decisions cast doubt on the precise statutory meaning of “value” and the fair treatment of “good faith” transferees. Although the court noted that the “good faith” defense contained in Bankruptcy Code Section 548(c) was meant to “protect ... the [good faith] transferee from his unfortunate selection of business partners,” *Positive Health*, 769 F. 3d at 903 (quoting *In re Hannover Corp.*, 310 F. 3d 796, 802 (5th Cir. 2002)), that statement provides small comfort to the good faith transferees in *Golf Channel* and *Positive Health*.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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