

# Alert

## Texas Supreme Court Resolves Fraudulent Transfer Value Defense for Fifth Circuit

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“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. *Janvey v. Golf Channel*, \_\_\_ S.W.3d \_\_\_, 2016 WL 1268188, at \*2 (Tex. April 1, 2016), *responding to Janvey v. Golf Channel Inc.*, 792 F.3d 539, 547 (5th Cir. 2015) (“*Golf Channel I*”). The Fifth Circuit, on March 11, 2015, had initially held an advertising firm in an SEC receiver’s Texas fraudulent transfer suit liable for \$5.9 million it had received in good faith from a Ponzi scheme debtor. *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).

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] affirmative defense under ... [TUFTA].” 2016 WL 1268188, at \*2.

### 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. *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.").

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." *In re Hannover Corp.*, 310 F.3d 796, 802 (5th Cir. 2002). 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." 2016 WL 1268188, at \*6. For that reason, the Fifth Circuit asked the Texas court to resolve the statutory "tension" on how "to measure 'reasonably equivalent value.'" 792 F.3d at 547. 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." 2016 WL 1268188, at \*6, 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." *Id.* at \*7.

### 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]." *Id.* at \*8. 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." *Id.* at \*9. 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." *Id.* 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." *Id.*

### 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." *Id.* (emphasis in original). But TUFTA "is unique among uniform fraudulent-transfer laws because it provides a specific market-value definition of 'reasonably equivalent value.'" *Id.* at \*10. 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, office supplies, and employee compensation or benefits — is simply unsupported under a plain reading of [TUFTA]." *Id.* at \*11. 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.” *Id.*, 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”). 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.” *Id.* at \*11, citing Tex. Bus. & Com. Code § 24.004(a). 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.” *Id.*

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.” *Id.* at \*12, 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). 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.” *Id.*

#### *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 value.” *Id.* at \*7. It specifically relied on *In re Fin. Federated Title & Trust, Inc.*, 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”). In that case, 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.” 2016 WL 1268188, at \*13. 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.” *Id.* at \*14, citing 309 F.3d at 1331-32.

#### *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.” *Id.* at \*15. 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. *Finn v. Alliance Bank*, 860 N.W.2d 638, 647 (Minn. 2015). 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.” 2016 WL 1268188, at \*15, quoting 860 N.W.2d at 649. 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.” *Id.*

#### *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.” *Id.* at \*16. 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] 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.” *Id.* 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.” *Id.* at \*17.

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.” *Id.*

#### **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.” *Golf Channel I*, 780 F.3d at 642-43. Thanks to the Texas Supreme Court, Golf Channel will be protected from its “unfortunate selection of [a] business partner.” *See In re Hannover Corp.*, 310 F.3d at 802.

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