ALERTS

Fifth Circuit Holds That Political Contributions From Ponzi Schemers Are Fraudulent Transfers

November 29, 2012

The United States Court of Appeals for the Fifth Circuit, on Oct. 22, 2012, held that $1.6 million in political contributions made to five different political committees by Ponzi scheme defendants between 2000 and 2008 were fraudulent transfers made "with actual intent to hinder, delay, or defraud creditors" under the Texas version of the Uniform Fraudulent Transfer Act. *Janvey v. Democratic Senatorial Campaign Committee, Inc., et al.*, 2012 WL 5207460 ___ F.3d ___ (5th Cir. 2012). Affirming the district court, the Court of Appeals explained that the court-appointed receiver stood "in the shoes of the creditors of the" Ponzi scheme defendants, enabling him to bring the fraudulent transfer claims, and that the receiver timely sued under Texas law "within one year after the transfer[s] . . . w[ere] or reasonably could have been discovered . . . ." *Id.*, at *3. Finally, the court affirmed the lower court's conclusion that the Federal Campaign Act of 1971, as amended, did not preempt the receiver's state law claim. *Id.*, at *5. Because the defendant committees could not show that they had given "reasonably equivalent value" for the contributions, they were unable to raise a good faith defense. *Id.*, at 2.

Relevance

The case confirms the legal significance of a Ponzi scheme. Just seven months earlier, on March 20, 2012, the Fifth Circuit had reversed a district court's fraudulent transfer judgment based on a financially troubled entity's gift to a charity because there was no proof of a Ponzi scheme.

American Cancer Society v. Cook, 675 F.3d 524, 526 (5th Cir. 2012) ("Not all securities frauds are Ponzi schemes."). As in *Janvey*, the transferor in *American Cancer Society* was the subject of a Securities Exchange Commission (SEC) receivership, not a bankruptcy case, and the plaintiff was its court-appointed receiver. Unlike *Janvey*, where the existence of a Ponzi scheme was undisputed, the court in *American Cancer* found no evidence in the record of "a traditional Ponzi scheme," enabling it to hold that the "district court erred in applying the presumption of [actual] fraudulent intent," applicable in Ponzi scheme cases. *Id.*, at 528.

Courts have regularly held that a so-called "Ponzi scheme" debtor presumptively makes transfers to its investors with actual fraudulent intent to hinder, delay or defraud other creditors. *Warfield v. Byron*, 436 F.3d 551, 558-59 (5th Cir. 2006) (*held*, receiver satisfied burden of showing fraudulent intent with evidence that transferor had created Ponzi scheme, and was thus, "as a matter of law, insolvent from its inception"), citing *Cunningham v. Brown*, 265 U.S. 1 (1924).

Ponzi Scheme Definition

The receiver's fraudulent transfer claim in *Janvey*, based on the transferor's actual intent, turned on the existence of a Ponzi scheme. According to the Fifth Circuit, a "Ponzi scheme is a 'fraudulent investment scheme in which money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments.'" *American Cancer Society*, 675 F.3d at 527, citing, *Janvey v. Alguire*, 647 F.3d 585, 597 (5th Cir. 2011) (quoting *Black's Law Dictionary*, 1198 (8th Ed. 2004). *Accord*, *Perkins v. Haines*, 661 F.3d 623, 625 n. 1 (11th Cir. 2011) ("the essence of a Ponzi scheme is to use newly invested money to pay off old investors and convince them that they are earning profits rather than losing their shirts.").

Receiver's Authority To Sue on Behalf of Creditors

The court summarily rejected the defendant committees' argument in *Janvey* that the plaintiff receiver could not sue on behalf of creditors. First, Texas law makes a receiver "the representative and protector of the interests of all persons, including creditors, shareholders and others, in the property of the receivership." 2012 WL 5207460, at *2, quoting *Sec.*

Trust Co. of Austin v. Lipsome Cnty., 180 S.W. 2d 151, 158 (Tex. 1944), cited in *Jones v. Wells Fargo Bank, N.A.*, 666 F.3d 955, 966 (5th Cir. 2012). Even though the transferor could not bring a fraudulent transfer suit, a receiver may do so when he "acts to protect innocent creditors." *Jones*, 666 F.3d at 966. Other circuits agree. *Marion v. TDI Inc.*, 591 F.3d 137, 148 (3d Cir. 2010); *Wuliger v. Man. Life Ins. Co.*, 567 F.3d 787, 795 (6th Cir. 2009); *Eberhard v. Marcu*, 530 F.3d 122, 132-33 (2d Cir. 2008); and *Scholes v. Lehmann*, 56 F.3d 750, 753-54 (7th Cir. 1995).

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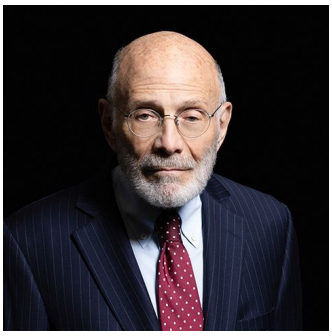

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