

ALERTS

Eleventh Circuit Broadly Defines ‘Value’ in Fraudulent Transfer Suit

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An insolvent corporate subsidiary’s payment of its parent’s contractual obligations was *not* a fraudulent transfer when “the [subsidiary] Debtor received reasonably equivalent value in exchange for [its cash] transfers,” held the U.S. Court of Appeals for the Eleventh Circuit on Sept. 4, 2015. *In re PSN USA, Inc.*, 2015 WL 5167803, at *7 (11th Cir. Sept. 4, 2015) (per curiam). Affirming the bankruptcy court’s dismissal of the Chapter 11 liquidation trust’s complaint, the Eleventh Circuit reasoned that “an insolvent debtor’s payment on behalf of [its] third party [parent] is not avoidable if the transfer ‘confers an economic benefit upon the debtor [subsidiary], either directly or indirectly.’” *Id.*, quoting *Rubin v. Mfrs. Hanover Trust Co.*, 661 F.2d 979, 991 (2d Cir. 1981). In short, the defendant provided services to the debtor subsidiary, those services constituted property, and the debtor paid for and used those services.

Relevance

The Eleventh Circuit avoided defining “value” three years ago in a major fraudulent transfer case. See *In re TOUSA, Inc.*, 680 F.3d 1298, 1311 (11th Cir. 2012). It reasoned there that “even if all of the purported benefits of the transaction were legally cognizable [as value], they did not confer *reasonably equivalent value*,” relying on the bankruptcy court’s factual findings after trial. *Id.* (emphasis added). In the view of the Eleventh Circuit at the time, the bankruptcy court’s fact findings in *TOUSA* as to the inadequacy of value were supported by the record, were not “clearly erroneous,” and should not have been reversed by the district court. *Id.* at 1310-13. *PSN*, however, squarely deals with the “value” issue, for the plaintiff

trust had conceded “that the payments to [the defendant] were reasonably equivalent in value to the ... services” provided by the defendant. 2015 WL 5167803, at *6.

Other appellate courts have recently wrestled with the definition of value. *See, e.g., In re Positive Health Management*, 769 F.3d 899, 904-05, 909 (5th Cir. 2014) (reversing lower courts, Fifth Circuit narrowed their holding that debtor had “received reasonably equivalent value in exchange for [its] cash transfers”; in effect, Fifth Circuit disregarded value of indirect economic benefits that had been provided to debtor by good faith lender, instead focusing on “the value that the transferee [defendant] gave up as its side of the bargain”); *Janvey v. The Golf Channel, Inc.*, 780 F.3d 64 (5th Cir. 2015) (reversing district court, held that defendant’s “services furthering a debtor’s Ponzi scheme provided no value to the debtor’s creditors”), petition for rehearing granted to extent of vacating earlier decision and certifying “value” issue to Texas Supreme Court, 2015 WL 3972216 (5th Cir. June 30, 2015).

Facts

The corporate parent of the subsidiary debtor in *PSN* had only contracted with the defendant for satellite services. Although the subsidiary was not obligated on its parent’s contract, it actually used the services for which it paid. 2015 WL 5167803, at *6. “In exchange for its payments, the Debtor [subsidiary] received from [the defendant] the ... services that were necessary for the Debtor’s business [operations]. For [its operations], the Debtor earned a service fee from its parent company As a non-operating holding company, ... [the parent] could not have used the satellite services [obtained by the Debtor].” *Id.* The parent, in fact, had no offices, no employees and no operations, and it was not authorized to do business in the United States.

According to the plaintiff trustee, “the Debtor’s receipt and use of the satellite services, and its [business] operation ... were solely for the benefit of [the parent].” Despite the debtor’s paying \$3 million to the defendant, the trust argued that the debtor’s payment did not “preserve [the debtor’s] net worth, and [its] staying in business ultimately worsened [its] condition and made its creditors worse off.” *Id.*

The bankruptcy court, granting the defendant’s motion for summary judgment, held that the debtor had received “reasonably equivalent

value” for two reasons: “(1) [It] received and used the satellite services; and (2) [the corporate parent] and the Debtor shared an identity of interests, such that any benefit [the parent] received under the contract also indirectly benefited the Debtor.” *Id.* at *2. The district court affirmed.

Applicable Law

The Eleventh Circuit applied the constructive fraudulent transfer provisions of the Bankruptcy Code (the “Code”), Section 548(a)(1)(B), and the relevant section of the Florida Uniform Fraudulent Transfer Act. Under both provisions, “a transfer of the debtor’s property ... can be avoided if the debtor ‘received less than a reasonably equivalent value in exchange for such transfer’ and the debtor was insolvent at the time of the transfer.” 2015 WL 5167803, at *3, citing Code § 548(a)(1)(B)(i) & (ii)(I) and Fla. Stat. § 726.105(1)(b).

The parties stipulated as to the debtor’s insolvency, leaving only the issue of whether the debtor had received “reasonably equivalent value.” In particular, the court focused on the meaning of “value,” defined by Code Section 548(d)(2)(A) as “property, or satisfaction or securing of a present or antecedent debt of the debtor.” *Id.*

Courts generally hold that a debtor’s “payment of a third party’s obligation does not constitute value” when it receives nothing in return. *In re Good Time Charley’s, Inc.*, 854 B.R. 157, 161 (Bankr. N.J. 1984) (“Any benefit to a third party is not factored into the fair consideration equation.”). “Thus, when a debtor transfers its property but the transferee gives the consideration to a third party, the debtor will not have received fair consideration in exchange for its property.” *H.B.E. Leasing Corp. v. Frank*, 48 F.3d 623, 638 (2d Cir. 1995). When the debtor does receive value, however, it may receive that value through a benefit conferred upon a third party. *In re Image Worldwide, Ltd.*, 139 F.3d 574, 579-82 (7th Cir. 1998) (indirect benefits to debtor may be considered when determining whether it received reasonably equivalent value for guarantee); *H.B.E. Leasing Corp.*, 48 F.3d at 639 (judgment debtor received fair consideration for its payments to attorneys for its co-defendants in RICO action; “multiple codefendants ... threatened with joint and several liability ... mounted a common defense, and one defendant paid the legal fees of the others”); *Rubin*, 661 F.2d at 991 (benefit to debtor may come indirectly through benefit to third party; key inquiry is whether net effect of transaction resulted in value to debtor’s estate); *In re Abatement Env’tl. Res. Inc.*, 102

Fed. Appx. 272, 277 (4th Cir. 2004) (fair consideration may exist when “the consideration given to the third person has ultimately landed in the debtor’s hands, or if the giving of the consideration to the third person otherwise confers an economic benefit upon the debtor”).

The Eleventh Circuit Analysis

The Eleventh Circuit rejected the plaintiff trust’s argument that the debtor had not received value. First, the court construed “the term ‘value’ broadly ...” 2015 WL 5167803, at *4, quoting *In re Am. Hous. Found.*, 785 F.3d 143, 163 (5th Cir. 2015). Consistent with this broad understanding of value, courts have considered “whether the transfer confers an economic benefit upon the debtor, either directly or indirectly.” *Id.* at *5, citing *In re Rodriguez*, 895 F.2d 725, 727 (11th Cir. 1990). In doing so, the Eleventh Circuit rejected the liquidation trust’s argument that had focused on whether the debtor received property rights or whether it was a party to the contract at issue. *Id.*, citing *In re N. Merch., Inc.*, 371 F.3d 1056, 1059 (9th Cir. 2004) (“Although Debtor was not a party to the ... loan, it clearly received a benefit from that loan.”).

According to the Eleventh Circuit, its prior decision in *Rodriguez* “recognizes that a party may have received an ‘economic benefit’ for purposes of determining ‘reasonably equivalent value’ if it ‘share[s] in the enjoyment of or use[s] a good or service’.” *Id.* at *6. Here, the debtor “was able to use the satellite services for which it paid, despite the fact that it was not obligated on” the contracts. *Id.* Also, because the debtor was able to “receive and use the full value of the satellite services” provided by the defendant, “the evidence shows that the Debtor indirectly benefited ... by using these services it received.” *Id.* at *7.

Comment

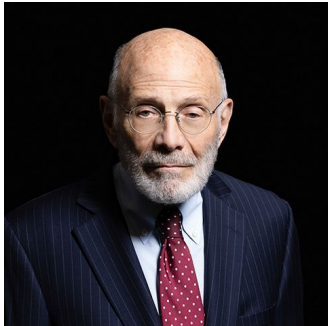
The Eleventh Circuit in *PSN* was correct, for it closely reviewed the stipulated facts to focus on the economic reality, not the formal corporate structure. As the court recognized, the debtor received the benefits of its parent’s contract with the defendant, regardless of the transaction’s form.

Authored by Michael L. Cook.

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

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