ALERTS

Fifth Circuit Narrowly Accepts Texas Supreme Court's Reading of Fraudulent Transfer Value Defense

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The U.S. Court of Appeals for the Fifth Circuit just affirmed the dismissal of an SEC receiver's fraudulent transfer suit against an advertising firm for $5.9 million it had received in good faith from a Ponzi scheme debtor. *Janvey v. Golf Channel Inc.*, 2016 U.S. App. LEXIS 15407, *7 (5th Cir. Aug. 22, 2016) ("*Golf Channel IV*"). We predicted this outcome in our April 6, 2016 *Alert* after the Texas Supreme Court ruled that "Golf Channel's media-advertising services had 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." *Janvey v. Golf Channel Inc.*, 2016 Tex. LEXIS 241, 487 S.W.3d 560, 570 (Tex. 2016) ("*Golf Channel III*"). According to the Texas Supreme Court, the Texas version of the Uniform Fraudulent Transfer Act ("TUFTA") should not be applied "in a way that would nullify a statutory affirmative defense [good faith receipt of funds in exchange for reasonably equivalent value] whenever the debtor was operating a Ponzi scheme." *Id.* at *530.

The Fifth Circuit begrudgingly accepted the Texas Supreme Court's reading of the definition of "value" contained in TUFTA after certifying the question to that court on June 30, 2015, in response to a petition for rehearing. *Janvey v. Golf Channel Inc.*, 792 F. 3d 539 (5th Cir. 2015) ("*Golf Channel II*"). On March 11, 2015, the Fifth Circuit had initially reversed the district court, holding the defendant advertising firm liable for its undisputed good faith receipt of cash 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 debtor).

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The district 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)," reasoning that the defendant "looks more like an innocent trade creditor than a salesman perpetrating and extending the [debtor's] Ponzi scheme." In its initial 2015 holding in *Golf Channel I*, however, the Fifth Circuit stressed that this case is "different because [the debtor] was engaged in a Ponzi scheme." It conceded, nevertheless, that the defendant's services might have been "quite valuable" had the debtor been engaged in a legitimate business.

Relevance

The Fifth Circuit acquiesced in the Texas Supreme Court's response. In its view, the Texas Court interpreted "the concept of 'value' under TUFTA differently than we have understood 'value' under other states' fraudulent transfer laws and under Section 548(c) [of] the Bankruptcy Code." 2016 U.S. App. LEXIS 15407, at *5. It cited its own precedents to support this position. *Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006) (applying Washington's UFTA statute, held services that furthered a Ponzi scheme not "value" as a matter of law because the "primary consideration in analyzing the exchange of value for any transfer is the degree to which the transferor's net worth is preserved"); *In re Fairchild Aircraft Corp.*, 6 F.3d 1119, 1125-27 (5th Cir. 1993), abrogated on other grounds by *In re Dunham*, 110 F.3d 286, 288-89 (5th Cir. 1997) (under Bankruptcy Code §548(c), inquiry is whether consideration provided in exchange for transfer conferred a tangible economic benefit on debtor, not whether consideration had objective value in the abstract). The Fifth Circuit stressed that its "prior decisions" remain "unaffected" by *Golf Channel III*. 2016 U.S. App. LEXIS 15407, at *7. In other words, if a Fifth Circuit trustee sues under Bankruptcy Code ("Code") 548(a)(1), the outcome would be different from the result in *Golf Channel III*, where the receiver sued under applicable state law — TUFTA. A good faith creditor paid in the ordinary course of a Ponzi scheme debtor's business will still be held liable, unable to raise the good-faith reasonably equivalent value defense contained in Code § 548 (c).

Analysis

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The Fifth Circuit ignored the substantial body of case law in other circuits and other state courts, implying that *Golf Channel III* merely construes a specific provision of Texas law and that the opinion is aberrational. But the Texas Supreme Court in *Golf Channel III* detailed the statutory purpose behind the Uniform Fraudulent Transfer Act before discussing relevant decisions by other federal courts and the decisions of at least one other state Supreme Court.

First, according to the Texas Legislature, TUFTA should 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." 2016 Tex. LEXIS 241, at *29. Second, the Texas Supreme Court considered other courts' "construction [of] the pertinent terms in cases applying" Bankruptcy Code §548 "and similar provisions in UFTA statutes enacted by other states." *Id.* at *30.

Most important, the Texas Supreme Court rejected the Fifth Circuit's view that a Ponzi scheme debtor failed to receive value when it paid for goods or services in good faith. *Id.* at *38-*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] at 548-70 (16th ed. 2016) (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 will discount "intangible and transitory assets and rights that have value only to the debtor"). Moreover, reasoned the Texas Court, "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 ... ." 2016 Tex. LEXIS 24, at *41, 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).

Nor did the Fifth Circuit in *Golf Channel IV* acknowledge the Eleventh Circuit's holding in *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

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and services provided rather than on the impact the goods and services had on the bankrupt enterprise"; court "dismissed … cases in which courts had held that value was lacking as a matter of law in compensation transactions involving a Ponzi scheme"). In the words of the Texas Supreme Court, "value is value regardless of whether the debtor is insolvent or whether either party is acting in good faith." 2016 Tex. LEXIS 241, at *50, citing *Fin. Federated*, 309 F. 3d at 1331-32.

Finally, the Fifth Circuit in *Golf Channel IV* ignored the "only … state high court" decision that "has addressed the Ponzi-scheme presumptions and good faith defense under an UFTA-based statute." *Id.* at *52, citing *Finn v. Alliance Bank*, 860 N.W. 2d 638, 647 (Minn. 2015) (construing Minnesota Uniform Fraudulent Transfer Act, court declined to apply Ponzi-scheme presumptions; "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'"). Like the Minnesota Supreme Court, the Texas Supreme 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.* at *53.

Comment

The Fifth Circuit has now unnecessarily complicated fraudulent transfer litigation in its circuit. By adhering to an unsound judge-made presumption in Ponzi scheme cases, the Fifth Circuit has undermined its previously stated acknowledgment that Code § 548(c)'s "good faith" defense 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). See also *In re Churchill Mortgage Inv. Corp.*, 264 B.R. 303, 308 (S.D.N.Y. 2001) (affirming bankruptcy court and applying Code § 548, 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, and applying Code §548, 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

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aside as fraudulent [transfers] … . The financial positions of the debtor need not necessarily be improved by a particular transaction in order for us to hold that value was given”).

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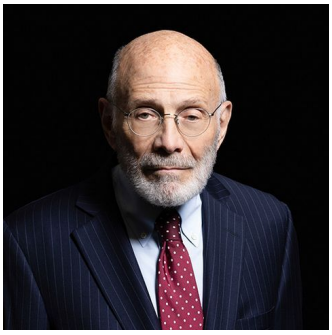

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