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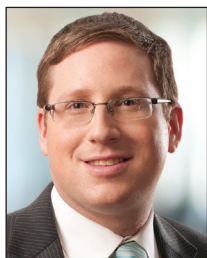
## Feature

BY EDWARD L. SCHNITZER AND JOSEPH ORBACH<sup>1</sup>

### Can Trade Creditors Provide “Value” in a Ponzi Scheme?



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As is often the case in Ponzi schemes, a trail of victims is left behind that ranges from investors who have lost their investments to creditors who are owed money for goods and services. Even parties that appear to survive a Ponzi scheme relatively unscathed are often hit with avoidance action lawsuits seeking the recovery of funds received. Now under a new strict standard set forth by the Fifth Circuit,<sup>2</sup> even unsuspecting trade creditors who provide goods or services at their fair market value may be required to return funds received from the operator of a Ponzi scheme.

#### Background

In the aftermath of the 2008 financial crisis, a number of Ponzi schemes were uncovered, including a \$7 billion fraud orchestrated by Robert Allen Stanford through his various entities, including Stanford International Bank.<sup>3</sup> In an effort to promote his fraudulent investment scheme to high-net-worth investors, Stanford became the title sponsor of the Stanford St. Jude's Championship, an annual Professional Golfers Association of America (PGA) tournament held in Memphis, Tenn.<sup>4</sup> In October 2006, Stanford entered into a two-year agreement with The Golf Channel for a range of marketing services, including more than 650 commercials, live coverage of Stanford's PGA event, and other promotional considerations.<sup>5</sup> The Golf Channel received \$5.9 million under this agreement.<sup>6</sup>

#### District Court Proceeding

By February 2009, the Securities and Exchange Commission uncovered Stanford's Ponzi scheme, and the U.S. District Court in the Northern District of Texas appointed Ralph S. Janvey to serve as the receiver.<sup>7</sup> Janvey took control of Stanford's assets and, pursuant to his avoidance powers, commenced a number of lawsuits to recover transfers.<sup>8</sup> One of those actions was a claim against The Golf Channel seeking to avoid the \$5.9 million in payments as alleged fraudulent transfers under the Texas Uniform Fraudulent Transfer Act (TUFTA). Following discovery, the receiver and The Golf Channel filed cross-motions for summary judgment. The district court ruled in favor of The Golf Channel and dismissed the action, holding that “[The] Golf Channel looks more like an innocent trade creditor than a salesman perpetrating and extending the Stanford Ponzi scheme.”<sup>9</sup>

In analyzing the TUFTA, the district court determined that The Golf Channel had no knowledge of the Stanford Ponzi scheme, and provided Stanford with “reasonably equivalent value” because it provided advertising time and services in an arm's-length transaction in good faith at fair market value in the ordinary course of its business.<sup>10</sup> Furthermore, in rejecting the receiver's argument that no value could be provided in the context of a Ponzi scheme, the court called such line of reasoning “nonsense.”<sup>11</sup> The court stated that under the standard advocated by the receiver, he

<sup>7</sup> *Id.*

<sup>8</sup> See, e.g. *Janvey v. Alguire*, 647 F. 3d 585 (5th Cir. 2011); *Janvey v. Democratic Senatorial Campaign Comm.*, 712 F. 3d 185 (5th Cir. 2013); *Janvey v. Brown*, 767 F. 3d 430 (5th Cir. 2014).

<sup>9</sup> *Janvey v. TGC LLC*, Case No. 3:11-CV-0294-N (N.D. Tex. Nov. 5, 2013) (Docket No. 93); *slip op.* at 1.

<sup>10</sup> *Id.* at 13 n.6.

<sup>11</sup> *Id.* at 12 (quoting *Samson v. U.S. West Commc'ns Inc. (In re Grigonis)*, 280 B.R. 950 (Bankr. D. Mont. 1997)).

<sup>1</sup> The views expressed in this article are those of the authors and may not reflect the views of the firm.

<sup>2</sup> *Janvey v. The Golf Channel Inc.*, 2015 WL 1058022, 2015 U.S. App. LEXIS 3818 (5th Cir. March 11, 2015).

<sup>3</sup> *The Golf Channel*, *slip op.* at 2.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 2-3.

<sup>6</sup> *Id.* at 3.

“would have [to file] a fraudulent transfer claim against the power company for the electricity [that] Stanford used and against the water company for the [water that was] used,” even though they provided reasonably equivalent value in the form of power or water.<sup>12</sup> The receiver appealed the district court’s dismissal to the Fifth Circuit.

## Fifth Circuit Opinion

In reversing the district court, the Fifth Circuit interpreted “reasonably equivalent value” in a completely different way. In reaching that decision, the court first noted that the TUFTA was “enacted to protect creditors against [the] depletion of the debtor’s estate,” which also applies in the context of a Ponzi scheme, proving the existence of the Ponzi scheme “establishes the fraudulent intent behind the transfers.”<sup>13</sup> As The Golf Channel did not challenge the existence of the Ponzi scheme, and the receiver did not challenge the district court’s finding that The Golf Channel took the transfers in good faith, the only legal issue before the court was whether The Golf Channel provided the debtor with “reasonably equivalent value.”<sup>14</sup>

In determining how to define “value,” the Fifth Circuit first looked at the text of the TUFTA, which defines “value” as “property ... transferred or an antecedent debt ... secured or satisfied.”<sup>15</sup> Next, the court made an “Erie guess” as to how Texas would interpret this definition.<sup>16</sup> The court looked to the relevant comment in the Uniform Fraudulent Transfer Act, which stated that “[c]onsideration having no utility from a creditor’s viewpoint does not satisfy the statutory definition.”<sup>17</sup>

In applying this standard of value, the circuit court noted that “[The] Golf Channel put forward no evidence that its services preserved the value of Stanford’s estate or had any utility from the Stanford creditors’ perspective,” and “only brought forth evidence showing the market value of its services.”<sup>18</sup> In addition, the court then held that, “as a matter of law,” The Golf Channel’s services could not have any value to Stanford’s creditors because its services extended the Ponzi scheme.<sup>19</sup> In reaching this conclusion, the Fifth Circuit held that the TUFTA does not provide any distinction for different types of services or transferees, and it would not “create an exception for trade creditors.”<sup>20</sup>

While noting that consumables or speculative investments could constitute “value” in certain circumstances, the circuit court held that in the context of a Ponzi scheme, such a showing would be very difficult as the provider would have to establish that, at the time of the transfer, the creditors had the possibility of benefiting from such a transfer.<sup>21</sup> That being said, the circuit court did leave open the possibility that an electricity provider could present evidence that its electricity “prevent[ed] the building’s deterioration to the benefit of the debtors’ creditors.”<sup>22</sup>

## Decision Reads Like a Preference Decision?

Much like the district court’s action in summarily dismissing the receiver’s contention that no value could be provided in a Ponzi scheme, the Fifth Circuit summarily dismissed The Golf Channel’s claim that “its own status as a creditor requires that we resolve the case in its favor.”<sup>23</sup> In rejecting that claim, the circuit court stated:

[The] Golf Channel is not the only creditor we must consider. It is one among many who have unsecured claims, and must wait its turn for a *pro rata* share of whatever remains in the Stanford estate.<sup>24</sup>

In requiring a review from the standpoint of creditors of every transfer made by the operator of a Ponzi scheme, one might argue that the circuit court analyzed The Golf Channel’s defenses as if the transfers were alleged to be preferential transfers under § 547 of the Bankruptcy Code, rather than alleged fraudulent transfers under TUFTA or § 548 of the Bankruptcy Code.

In a preference action, the presence of antecedent debt is not a defense — in fact, it is a required element.<sup>25</sup> On the other hand, in a fraudulent transfer case, satisfaction of a genuine antecedent debt is a complete defense.<sup>26</sup> For a preference, a court addresses “an infraction of the rule of equal distribution among all creditors.”<sup>27</sup> On the other hand, in a fraudulent transfer matter, a court attempts to remedy a situation where “[a] debtor seeks, through deceitful means, to secure a personal advantage out of what ... should belong to creditors and not to the debtor.”<sup>28</sup>

By definition, fraudulent transfers are generally harmful to creditors by wrongfully depleting the estate.<sup>29</sup> On the other hand, a preference payment is not an attempt to remove assets beyond creditors’ reach; it is simply the payment of a valid antecedent debt. By noting that The Golf Channel “is one among many who ... must wait its turn for a *pro rata* share of whatever remains in the Stanford estate,” the Fifth Circuit seemed to be treating The Golf Channel as a preference defendant that must return its transfers to the estate and then wait for its *pro rata* distribution along with other unpaid creditors.<sup>30</sup>

## Distinction Between Investors and Trade Creditors?

Perhaps what was most surprising in the Fifth Circuit’s decision was its citation to its own prior decision involving the Stanford Ponzi scheme.<sup>31</sup> Just six months earlier, in *Janvey v. Brown*, the Fifth Circuit held that “principal payments made to [investors] are not subject to TUFTA

23 *Id.* at 9, n.8. It is unclear from both the opinion and the appellate brief whether The Golf Channel believed that having a claim against the Stanford estate by itself was a defense to the fraudulent transfer claim, or if it believed that since it was a valid creditor at the time of payment that it was entitled to the reasonably equivalent value defense under TUFTA.

24 *Id.* at 9, n.8.

25 See 11 U.S.C. § 547(b)(2).

26 See generally *Henry v. Lehman Commer. Paper Inc. (In re First Alliance Mortg. Co.)*, 471 F.3d 977, 1008 (9th Cir. 2006).

27 5 *Collier on Bankruptcy* ¶ 547.01, at 547-9 (Lawrence P. King ed., 15th rev. ed. 1997).

28 *Id.*

29 See generally D.R. Cowans, *Bankruptcy Law and Practice* § 10.9(c), at 351 (1994).

30 *The Golf Channel* at 9, n.8. It is unclear from the opinion whether The Golf Channel is entitled to a claim for the \$5.9 million that it is required to return, or if it can only share in the proceeds of any distributions because it remained a creditor of Stanford at the time that the Ponzi scheme was uncovered since it had not been paid in full when it was discovered.

31 *The Golf Channel* at 4 (“In this circuit, proving that [a debtor/transferor] operated as a Ponzi scheme establishes the fraudulent intent behind the transfer its made.” *Janvey v. Brown*, 767 F.3d 430, 443 (5th Cir. 2014)).

12 *Id.* at 12.

13 *The Golf Channel* at 4-5.

14 *Id.* at 5.

15 *Id.* at 6 (quoting Tex. Bus. & Com. Code § 24.004(a)). The definition of “value” under § 548 of the Bankruptcy Code also includes the satisfaction of an antecedent debt. 11 U.S.C. § 548(d)(2)(A).

16 *Id.*

17 *Id.* at 7 (quoting from Uniform Fraudulent Transfer Act § 3, cmt. 2).

18 *Id.* at 8.

19 *Id.*

20 *Id.* at 9.

21 *Id.*

22 *Id.* at 8, n.7.

claims” since “it is undisputed that the principal payments were payments of an antecedent debt, namely fraud claims that the [investors] have as victims of the Stanford Ponzi scheme.”<sup>32</sup> Unlike *The Golf Channel* decision, the Fifth Circuit provided no additional analysis of why the antecedent debt in *Brown* was a complete defense to a TUFTA claim.

Comparing the Fifth Circuit’s holdings in *The Golf Channel* and *Brown* leaves one wondering if the Fifth Circuit was intentionally making a distinction between how investors and trade creditors should be treated as defendants in a TUFTA avoidance action, or instead, whether the decisions were simply the product of different judges coming to different conclusions. What we do know is that The Golf Channel has requested that the full circuit court re-hear the case and has cited to *Brown* as the creation of an intra-circuit split that requires clarification.

## What Should a Trade Creditor Do?

Under this new standard, it is unclear what a trade creditor can do to protect itself in the Fifth Circuit. Is charging fair-market prices in an arm’s-length transaction no longer enough to satisfy the standard of reasonably equivalent value? Must a trade creditor, before entering into a transaction with a customer, determine whether all the creditors of the customer are benefiting from the transaction? Assuming that such a determination could even be made, does it count if that determination is made before the discovery of the Ponzi scheme, or would it be invalid because the creditors were unaware of the true nature of the customer/Ponzi scheme? For instance, it is not hard to imagine that if the Stanford investors were asked prior to the discovery of the Ponzi scheme in February 2009 for their views on the services provided by The Golf Channel, they would have said that such services “preserved the value of Stanford’s estate.”

## Conclusion

Unless this opinion is reversed and vacated in an *en banc* rehearing or on further appeal to the U.S. Supreme Court, or the Texas legislature clarifies the TUFTA to state that the satisfaction of a legitimate antecedent debt constitutes reasonably equivalent value even in a Ponzi scheme, trade creditors must beware. All receipts are subject to a clawback if it is later determined that the legitimate services were provided to a Ponzi scheme operator. Customers that provided trade creditors with steady, safe income streams are now liabilities in waiting, and the putting green has suddenly turned into a sandtrap. **abi**

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<sup>32</sup> *Janvey v. Brown*, 767 F.3d at 443. In addition, The Golf Channel made this very argument to the Fifth Circuit, but could not cite to *Brown* as it was issued after the court took this matter under advisement.