Can Michigan Creditors Find the Green? The Impact of Janvey v Golf Channel *on Fraudulent Transfers in Ponzi Schemes*

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Introduction

In recent years, Ponzi schemes have gripped the nation. From Bernie Madoff in New York to Dante DeMiro in Michigan, con men have taken advantage of tens of thousands of investors for their own benefit and left creditors footing the bill.

But what happens when they get caught? In addition to criminal proceedings, the individual perpetrating the fraud and, if applicable, the entities through which the individual operated, will typically enter insolvency proceedings. A trustee or receiver is then appointed to seek to recover assets for the benefit of the defrauder's unsecured creditors, which largely consist of swindled investors. Many of these assets will come from the prosecution of fraudulent transfer claims under the Bankruptcy Code and state law.

Courts routinely struggle with balancing the interests of defrauded investors against innocent third-parties who unwittingly received payments from the criminal enterprise. That struggle has only intensified in the past decade as Ponzi schemes have become more prevalent and larger in scope. The Fifth Circuit Court of Appeals recently introduced greater uncertainty in this area by arguably broadening a receiver's power to claw back payments from vendors unknowingly doing business with Ponzi scheme operators. Specifically, the court held that the court-appointed receiver of a failed Ponzi scheme could recover nearly $6 million that the scheme spent advertising on a major cable network because the network failed to provide "reasonably equivalent value" in exchange for the transfers. The court found that the services provided by the cable network only served to diminish, rather than enhance, the defrauder's estate from the creditors' point of view and, therefore, "reasonably equivalent value" did not exist.

While the Fifth Circuit ultimately reversed its decision after certifying the issue to the Texas Supreme Court, practitioners should be wary of the decision's impact on fraudulent transfer law. No Michigan court has specifically addressed this issue, leaving open the possibility that the Fifth Circuit's rationale could appear in this state's jurisprudence. This article will further explore the Fifth Circuit's decision and its potential impact on fraudulent transfers resulting from a Ponzi scheme.

Two Types of Fraudulent Transfer Claims—Actual and Constructive

Both the Bankruptcy Code and state law provide a means for bringing fraudulent transfer claims. Under section 548 of the Bankruptcy Code, a trustee may avoid, among other things, any transfer of an interest of a debtor in property if (A) the debtor made such transfer with actual intent to hinder, delay, or defraud; or (B) the debtor received less than a reasonably equivalent value in exchange and was insolvent.[1] Likewise, under state law, a creditor may generally assert nearly identical claims under sections 4 and 5 of the Uniform Fraudulent Transfer Act ("UFTA") or its successor, the Uniform Voidable Transactions Act ("UVTA"). Transfers involving a transferor's actual intent to hinder, delay, or defraud are commonly referred to as actual fraudulent transfers, while transfers involving reasonably equivalent value and insolvency are referred to as constructive fraudulent transfers.

The Ponzi Scheme Presumption and Defenses

Courts have developed a number of peculiar rules regarding fraudulent transfers arising from Ponzi schemes. The most notable is the "Ponzi scheme presumption," which is the presumption that, as a matter of law, a Ponzi scheme transferor is presumed to have actually intended to "hinder, delay, or defraud" creditors with respect to any transfer made during the scheme.[2] For instance, the Sixth Circuit Court of Appeals has stated that "the question of intent to defraud [in a Ponzi scheme] is not debatable."[3] This is because "[o]ne can infer an intent to defraud future undertakers from the mere fact that a debtor was running a Ponzi scheme."[4] Indeed, "no other reasonable inference is possible. A Ponzi scheme cannot work forever. The investor pool is a limited resource and will eventually run dry. The perpetrator must know that the scheme will eventually collapse as a result of the inability to attract new investors."[5] The Ponzi scheme presumption creates a *prima facia* case that a trustee or receiver may recover 100% of any transfer (including principal returned to investors) effectuated during the time an individual or entity operated a Ponzi scheme, absent applicable defenses.[6]

However, that presumption does not guarantee victory to a trustee or receiver asserting a fraudulent transfer claim in a Ponzi scheme context. The Bankruptcy Code and the UFTA/UVTA provide that even if the Ponzi scheme operator makes a transfer with actual intent to defraud, the transfer is not voidable if the transferee took the transfer in "good faith" and in exchange for reasonably equivalent value. Specifically, 11 USC 548(c) states that a transferee of a transfer that "takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred . . . to the extent that such transferee . . . gave value to the debtor in exchange for such transfer." Similarly, section 8(a) of the UFTA/UVTA states that an actual fraudulent transfer is not voidable against a person who "took in good faith and for a reasonably equivalent value." Courts have construed "for value" in section 548(c) and "reasonably equivalent value" in section 8(a) to have the same fundamental meaning.[7]

These affirmative defenses set the stage for a difficult question: should an "innocent" transferee who has no reason to suspect illegal activity be entitled to keep proceeds from an illegal enterprise? Several court opinions address this issue in the context of an unwitting broker working for a Ponzi scheme's perpetrator. The majority of case law permits an innocent broker to retain the transfers. For example, the Southern District of New York has held that a transferor "received 'value' in exchange for the commissions paid to the Brokers for performing in good faith a facially lawful and customary service for which they were retained by the Debtors."[8] The court indicated that the appropriate focus is "the value of the goods and services provided rather than . . . the impact that the goods and services had on the bankruptcy enterprise."[9]

Yet, there is significant case law holding that such brokers can never provide reasonably equivalent value. For example, the Bankruptcy Court for the Northern District of Illinois has held that enforcing any broker agreement "would only exacerbate the harm to the debtor's creditors" and that the solicitation "could not give any 'value' to the estate for promoting a Ponzi scheme."[10] That court went on to hold that the transferees' failure to provide value for services mooted any inquiry into whether the transferees could demonstrate good faith under section 548(c).[11]

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The Fifth Circuit's Recent Opinion

This question regarding "reasonably equivalent value" becomes even more difficult when the transferee is a third-party unknowingly selling goods or services to the Ponzi scheme operator in an arms-length transaction. The Fifth Circuit Court of Appeals recently addressed this situation in *Janvey v Golf Channel, Inc*, 780 F3d 641 (5th Cir 2015). The case stemmed from a multi-billion dollar Ponzi scheme operated by Stanford International Bank, Ltd. ("Stanford"). For nearly two decades, Stanford promised investors "exceptionally high rates of return on certificates of deposits (CD), and sold these investments through advisors employed at . . . affiliated entities."[12] Some early investors "received the promised returns, but, as was later discovered, these returns were merely other investors' principal. Before collapsing, Stanford had raised over $7 billion selling these fraudulent CDs."[13]

In furtherance of the Ponzi scheme, Stanford marketed its services to sports audiences by purchasing advertising on The Golf Channel, Inc. ("Golf Channel"). This marketing included year-long commercial airtime and live coverage of the Stanford St. Jude's Championship, which was sponsored by Stanford. By 2011, Stanford had paid Golf Channel at least $5.9 million for advertisements.

In February 2009, the Securities and Exchange Commission uncovered Stanford's Ponzi scheme and filed a lawsuit against the company in a Texas federal district court, after which a receiver was appointed. The receiver discovered the payments to Golf Channel and filed suit against the company alleging that the transfers were fraudulent under Texas's version of UFTA ("TUFTA"). The parties subsequently filed cross-motions for summary judgment, which the district court granted in favor of Golf Channel "Despite the fact that Golf Channel offered no evidence to show how its services benefitted Stanford's creditors."[14] The district court determined that although Stanford's payments to Golf Channel were fraudulent, the company was "entitled to judgment as a matter of law on its affirmative defense that it received the payments in good faith and in exchange for reasonably equivalent value."[15] Importantly, the district court measured "reasonably equivalent value" as the market value of advertising on Golf Channel.

In reviewing the district court's opinion, the Fifth Circuit held that the only issue for the court to decide was whether "the property or service exchanged categorically had any value under TUFTA."[16] The court then began its analysis by reviewing the definition of "value" under TUFTA, which includes "property transferred or an antecedent debt secured or satisfied, but . . . does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person."[17] The Fifth Circuit took an "*Erie* guess" as to how Texas would interpret the definition because the issue had not been previously addressed by a Texas court.

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The Fifth Circuit noted that TUFTA expressly instructs courts to "apply and construe its provisions so as to effectuate UFTA's general purpose to make uniform the law with respect to the subject of UFTA among states enacting it."[18] To that end, the Fifth Circuit considered the comments to UFTA, authorities interpreting other states' UFTA provisions, and interpretations of section 548 of the Bankruptcy Code. In UFTA, the comment to the definition of value states that "[t]he definition is not exclusive and is to be determined in light of the purpose of the Act and to protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors. *Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition*."[19] Thus, "courts are left to define the contours of 'value' and the primary consideration is the degree to which the transferor's net worth is preserved."[20] Unlike the district court, the Fifth Circuit held that "value" is to be measured from the standpoint of the creditors, not from that of a buyer in the marketplace.

The Fifth Circuit then noted that Golf Channel failed to put forward any evidence "that its services preserved the value of Stanford's estate or had any utility from the creditors' perspective."[21] Rather, Golf Channel only put forward evidence showing the market value of its services. Such evidence, the Fifth Circuit held, was insufficient to satisfy Golf Channel's burden under TUFTA of proving value to Stanford's creditors.

While the lack of evidence alone required reversal, the Fifth Circuit went on to hold that Golf Channel's services "did not, as a matter of law, provide any value to Stanford's creditors" because "[w]hile Golf Channel's services may have been quite valuable to the creditors of a legitimate business, they ha[d] no value to the creditors of a Ponzi scheme."[22] This is so because Ponzi schemes, by definition, create greater liabilities than assets with each subsequent transaction. "Each new investment in the Stanford Ponzi scheme *decreased* the value of the estate by creating a new liability that the insolvent business could never legitimately repay. Services rendered to encourage investment in such a scheme do not provide value to the creditors."[23] Accordingly, the Fifth Circuit reversed the district court and rendered judgment in favor of the receiver.

The Texas Supreme Court Disagrees with the Fifth Circuit

After the Fifth Circuit rendered its opinion, Golf Channel filed a petition for a panel rehearing, which the Fifth Circuit granted.[24] The Fifth Circuit then vacated its previous opinion and certified the issue to the Texas Supreme Court.

Construing the relevant statutory provisions, the Texas Supreme Court held that TUFTA's "reasonably equivalent value" requirement "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."[25]

Central to the court's decision was its conclusion that "TUFTA is unique among uniform fraudulent-transfer laws because it provides a specific market-value definition of 'reasonably equivalent value.'"[26] TUFTA's definition of "reasonably equivalent value" states: "'Reasonably equivalent value' includes without limitation, a transfer or obligation that is within the range of values for which the transferor would have sold the assets in an arm's length transaction."[27] The definition provides an illustration of an exchange by the transferor that occurred for fair market value in an arm's-length transaction, with the reasonably equivalent value of the exchange evaluated objectively at the time of the transfer.

The court also noted that the definition of "value" does not require consideration "that can be sold to satisfy the debtor's creditors' claims."[28] Its meaning is expansive and nonexclusive. The court concluded:

> Whether a debtor obtained reasonably equivalent value in a particular transaction is determined from a reasonable creditor's perspective at the time of the exchange, without regard to the subjective needs or perspectives of the debtor or transferee and without the wisdom hindsight often brings. Considering TUFTA's definitions of "value" and "reasonably equivalent value" as applied to the circumstances of this case, we conclude the reasonably equivalent value requirement in section 24.009(a) of TUFTA is satisfied when the transferee fully performed in an arm's-length transaction in the ordinary course of its business at market rates.[29]

After the Texas Supreme Court issued its opinion, the Fifth Circuit affirmed the district court's opinion in favor of Golf Channel.[30] The Fifth Circuit did note, however, that "The Supreme Court of Texas's answer interprets 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."[31] Therefore, the binding effect of the Fifth Circuit's decisions interpreting other states' UFTA statutes and section 548(c) of the Bankruptcy Code remains.

The Aftermath

The full impact of the Fifth Circuit's rationale in *Golf Channel* is unknown. If it is adopted in other courts across the country, a trustee or receiver's ability to recover transfers from third-party vendors in a Ponzi scheme context could dramatically expand. While swindled investors may welcome that shift, it would also introduce greater uncertainty in the marketplace. The costs of unwittingly providing goods or services to a Ponzi scheme operator must be borne by someone. It is uncertain if and how parties would attempt to shift those costs onto others.

That uncertainty is especially present under Michigan law. No Michigan court has opined on how "reasonably equivalent value" should be viewed within the context of a Ponzi scheme. How Michigan courts will rule on these issues is, at best, an educated guess.

The Michigan Court of Appeals has provided guidance in a fact pattern unrelated to any Ponzi scheme. In *Dillard v Schlussel*, the court stated that "'[r]easonably equivalent value' is a commercial concept. The touchstone is whether the transaction conferred realizable commercial value on the debtor reasonably equivalent to the realizable commercial value of the assets transferred."[32] That statement suggests that a Michigan court may take a view similar to the Texas Supreme Court when addressing a Ponzi scheme, finding that "reasonably equivalent value" should be evaluated from a creditor's point of view in the marketplace, as Michigan's UVTA contains nearly identical provisions to TUFTA.

However, that result is anything but certain. TUFTA specifically defines "reasonably equivalent value," whereas Michigan's UVTA does not. Moreover, Michigan courts have previously looked to federal law in construing its own UFTA, and will presumably do so with UVTA.[33] It is entirely possible that a Michigan court could adopt the Fifth Circuit's rationale within the context of a Ponzi scheme and, therefore, arguably strengthen a trustee's or receiver's ability to claw back transfers made to innocent third-party vendors.

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Conclusion

As demonstrated by *Golf Channel*, how a court views "reasonably equivalent value" results in drastically different outcomes for a Ponzi schemer's unsecured creditors. If viewed from the standpoint of the defrauder's creditors, i.e., whether the transfer serves to diminish or enhance the estate, creditors providing intangible goods such as Golf Channel will likely lack a defense to fraudulent transfer claims. But if these transfers are viewed from the marketplace, those same creditors will likely have a complete defense to these same claims.

Practitioners should be aware that a Michigan court may take either approach and plan accordingly when prosecuting or defending fraudulent transfer claims in a Ponzi scheme context.

NOTES

1. 11 USC 548(a).

2. *See, e.g.*, *Donell v Kowell*, 533 F3d 762, 770 (9th Cir 2008); *Klein v Cornelius*, 786 F3d 1310, 1320 (10th Cir 2015); *Wiand v Lee*, 753 F3d 1194, 1201 (11th Cir 2014); *Zazzali v 1031 Exch Grp LLC (In re DBSI, Inc)*, 476 BR 413, 422 (Bankr D Del 2012); *Bear, Sterns SEC Corp v Gredd (In re Manhattan Inv Fund Ltd)*, 397 BR 1, 13 (SDNY 2007); *but see Finn v All Bank*, 860 NW2d 638, 653 (Minn 2015).

3. *Conroy v Shott*, 363 F2d 90, 92 (6th Cir 1966); *see also Sturrus v Department of Treasury*, 292 Mich App 639, 647, 809 NW2d 208, 213 (2011) ("And in any event, it is well established that in the absence of a defense under 11 USC 548(c) a bankruptcy trustee may recover the full amount paid to Ponzi scheme investors under [section] 548(a)(1)(A), because the question of intent to defraud is not debatable.").

4. *Emerson v Maples (In re Mark Benskin & Co)*, Nos 94-5421/94-5422, 1995 US App LEXIS 16053, at *12 (6th Cir June 26, 1995) (citation omitted).

5. *Id.* at *12-13 (citation omitted).

6. *See, e.g.*, *Donell*, 533 F3d at 771 n4 ("Under the actual fraud theory, the good faith losing investor is technically still liable even if his net transactions are negative, because even payments that total less than the amount of that investor's initial outlay were made 'with actual intent to hinder, delay, or defraud a creditor of the debtor.'" (citation and alterations omitted)).

7. *See Rieser v Hayslip (In re Canyon Sys Corp)*, 343 BR 615, 651 (Bankr SD Ohio 2006).

8. *Balaber-Strauss v Lawrence*, 264 BR 303, 308 (SDNY 2001).

9. *Id.* at 307.

10. *Martino v Edison Worldwide Capital (In re Randy)*, 189 BR 425, 441 (Bankr ND Ill 1995)

11. *Id.* at 442.

12. *Janvey v Golf Channel, Inc*, 780 F3d 641, 642 (5th Cir 2015).

13. *Id.*

14. *Id.* at 643.

15. *Id.*

16. *Id.* at 644.

17. *Id.* (alterations omitted).

18. *Id.* at 645 (citation and alterations omitted).

19. *Id.* (citation and alterations omitted) (emphasis in original).

20. *Id.* (citation and alterations omitted).

21. *Id.* at 646.

22. *Id.*

23. *Id.* (citations omitted) (emphasis in original).

24. *See Janvey v Golf Channel, Inc*, 792 F3d 539 (5th Cir 2015).

25. *Janvey v Golf Channel, Inc*, 487 SW3d 560, 564 (Tex 2016).

26. *Id.* at 563.

27. *Id.* at 569 (citation omitted).

28. *Id.* at 575.

29. *Id.* at 582.

30. *Janvey v Golf Channel, Inc*, 834 F3d 570, 573 (5th Cir 2016).

31. *Id.*

32. *Dillard v Schlussel*, 308 Mich App 429, 459, 865 NW2d 648, 663 (2014) (citation omitted).

33. *See, e.g.*, *Steinberg v Young*, No 09-11836, 2010 US Dist Lexis 31996, at *11 (ED Mich Mar 31, 2010) ("Though the Michigan Uniform Fraudulent Transfer Act does not define 'reasonably equivalent value,' Michigan Courts have imported the analysis used in the Federal Bankruptcy Code, which assists Bankruptcy Courts in evaluating similar issues."); *Gold v Marquette Univ (In re Leonard)*, 454 BR 444, 447 n9 (Bankr ED Mich 2011) (holding that Michigan's fraudulent transfer statute is similar to 11 USC 548(a)(1)(A)).

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