Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

SEPTEMBER 2016

LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Kent K. B. Hanson, J.D. at 415-908-3207

Email: .... kent.hanson@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . (800) 833-9844

Outside the United States and Canada, please call . . . . (518) 487-3000

Fax Number . . . . (518) 487-3584

Customer Service Web site . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call

Your account manager or . . . . (800) 223-1940

Outside the United States and Canada, please call . . . . (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2016-Pub.4789)

Editor-in-Chief, Editor & Board of Editors

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

Fraudulent Transfers in the Ponzi Era

By Michael Napoli and Eduardo Espinosa*

Fraudulent transfer law has developed in the context of Ponzi and other fraudulent schemes. The particularized circumstances of those cases has led to analytical shortcuts, the so-called "Ponzi presumptions," which have at times been applied too broadly. The authors of this article explain the Ponzi presumptions and analyze two recent state court cases that have challenged the rationale underlying these presumptions.

In recent years, fraudulent transfer law has developed in the context of Ponzi and other fraudulent schemes. The particularized circumstances of those cases has led to analytical shortcuts, the so-called "Ponzi presumptions," which, while appropriate to the circumstances out of which they arose, have at times been applied too broadly. As a result, fraudulent transfer law as practiced in the federal courts has become very favorable to bankruptcy trustees and receivers.

Two recent state court cases have challenged the rationale underlying the Ponzi presumptions. Last year, in *Finn v. Alliance Bank*,[1] the Minnesota Supreme Court expressly rejected the presumption that transfers made in furtherance of a Ponzi scheme are made with actual intent to defraud. This year, the Texas Supreme Court in *Janvey v. The Golf Channel, Inc.*[2] rejected the argument that the reasonably equivalent value exchanged for a questioned transfer should be judged differently in cases involving fraudulent schemes. It is too soon to tell whether these two cases will lead to the wholesale reversal of the lengthy list of federal cases favoring trustees. These cases do, however point out some of the dangers of uncritical reliance on the presumptions outside of the narrow context in which they were created.

THE RISE OF THE PONZI PRESUMPTIONS

For the last 15 years, the development of fraudulent transfer law has been driven by the federal courts in the context of Ponzi schemes. Whether the SEC

---

[*] Michael Napoli is a member of Dykema Gossett PLLC's Business Litigation Group, where he works on a variety of cases including securities, commercial, and products liability matters. Eduardo Espinosa is a member of the firm's Business Services Group advising clients regarding the legal and regulatory aspects of their commercial and transactional opportunities. Based in Dallas, the authors may be reached at mnapoli@dykema.com and eespinosa@dykema.com, respectively.

[1] 860 N.W.2d 638 (Minn. 2015).

[2] ___ S.W.3d ___, 2016 Tex. LEXIS 241 (Tex. 2016) (*Golf Channel III*).

has become more aggressive in uncovering schemes or criminals have become more sophisticated, this century has seen an increased number of large Ponzi schemes. Bernie Madoff and Allen Stanford may be the largest and best known; but there were many others involving millions of dollars and tens of thousands of victims. Some of these schemes have been resolved in bankruptcy and others in federal equity receiverships.

Regardless of the forum, a fiduciary—a trustee, a committee or a receiver—has been tasked with recovering assets that the debtor disbursed in furtherance of the scheme or to otherwise place them out of the reach of creditors. This has led to extensive litigation over fraudulent transfers, generally under state fraudulent transfer law—the Uniform Fraudulent Transfer Act ("UFTA").[3]

This litigation differed from traditional fraudulent transfer litigation. The prototypical fraudulent transfer case involves a business—the debtor—which has suffered a business reversal, usually a large claim from a supplier or customer. Seeing that the business cannot recover from the claim, the owners transfer assets to themselves, a new entity, a friend or family member in order to evade the claim but continue to operate the business. Notably, the badges of fraud contained in Section 4 of UFTA describe exactly this situation.

A Ponzi scheme is completely different. There is no actual business but merely a criminal enterprise that exists by taking money from B to pay A; and C to pay B and so forth until the scheme inevitably collapses. Money is skimmed off of the scheme for the benefit of the scheme's principals and those who lured the unwary investors into the scheme. Other, even larger sums of money, are paid to early investors in the form of fake "profits" to create and maintain the illusion that the scheme is generating investment income. Certain of the investors participate knowing (or, at least, strongly suspecting) that the enterprise is a Ponzi scheme recognizing that early participants can make large amounts of money off of the scheme if they can get their money out before the scheme collapses.

Because of their "rob Peter to pay Paul" nature, Ponzi schemes typically involve numerous transfers of money in and out of the scheme involving investors, sales agents and principals. In even a medium sized scheme, the number of transferees can number in the thousands and questionable transfers

---

[3] Despite its name, there are variations in UFTA as it has been adopted in the various states. None of these variations has been significant in this context. In addition, bankruptcy trustees can also sue under 11 USC § 548. While not identical, Section 548 is sufficiently similar to UFTA that the fraudulent transfer analysis at issue is the same under both state and federal law. *Golf Channel III*, 2016 Tex. LEXIS 241 at *29. For convenience, this article will refer only to UFTA.

in the tens of thousands.[4] The trustee will sue the "net winners," those investors who received more from the scheme than they contributed; those investors who were willing participants; the sales agents and the principals.

The court is faced with litigation involving hundreds of defendants and thousands of transfers. Each of the transfers is largely similar arising from the same base of operative facts. Nevertheless, evaluating each transfer separately is a practical impossibility. It is also very expensive drawing down funds that could otherwise be used to compensate the victims of the fraud. In order to solve this problem, the federal courts developed several evidentiary presumptions. First, transfers in furtherance of a Ponzi scheme are presumed to be made with an actual intent to hinder, delay or defraud a creditor. Second, the operator of a Ponzi scheme (the debtor) is insolvent as a matter of law. Third, the payments of false profits to investors or commissions to sales agents are transfers without the receipt of equivalent value. These presumptions are often collectively referred to as the "Ponzi presumptions." In their initial form, these presumptions are merely evidentiary and subject to rebuttal by contrary evidence.[5] Properly applied, the Ponzi presumptions are natural applications of UFTA.

As Originally Created, the Ponzi Presumptions Are Supported by and Consistent with UFTA

UFTA is "designed to protect creditors from being defrauded or left without recourse due to the actions of unscrupulous debtors."[6] It generally disallows transfers or obligations made with either actual or constructive intent to delay, hinder or defraud creditors.[7] Actual intent can be shown by either direct or circumstantial evidence. Because there is rarely evidence of actual intent to defraud, UFTA provides a non-exclusive list of "badges of fraud" that courts may consider in determining the debtor's intent.[8] The badges include such things as actual or prospective insolvency, whether the debtor received reasonably equivalent value, whether the transfer was to an insider or whether the debtor retained control over the assets after transfer.[9]

---

[4] For example, in *In re Independent Clearing House Co.*, 77 B.R. 843 (D. Utah 1987), the trustee brought more than 2,000 adversary proceedings to recover alleged fraudulent transfers to investors in a Ponzi scheme.

[5] *E.g.*, *In re Polaroid Corp.*, 472 B.R. 22, 42 (Bankr. D. Minn. 2012) (applying the presumptions where the defendant failed to provide evidence to rebut them).

[6] *KCM Finance, LLC v. Bradshaw*, 457 S.W.3d 70, 89 (Tex. 2015).

[7] UFTA, § 4(a).

[8] *Ho v. MacArthur Ranch, LLC*, 395 S.W.3d 325, 328–29 (Tex. App. 2013).

[9] UFTA, § 4(b).

Constructive intent can be shown by transfers for less than equivalent value where the debtor is prospectively insolvent. UFTA provides two definitions of prospective insolvency. First, the debtor was engaged or about to engage in a business for which its remaining assets were unreasonably small.[10] In other words, the debtor was heading down a path where its liabilities will exceed its assets; insolvency as defined by UFTA. Second, the debtor intended to incur or reasonably should have believed that it would incur debts beyond its ability to pay as they became due.[11] This definition ties to UFTA's presumption that a debtor is insolvent if it is not generally paying its debts as they come due.[12]

By Operating A Ponzi Scheme, the Debtor Intends to Defraud Its Creditors by Paying False Profits to Investors and Illegal Commissions to Sales Agents

The first of the Ponzi presumptions is that transfers made in furtherance of a Ponzi scheme were made with an actual intent to defraud creditors. As originally conceived, transfers in furtherance of a scheme referred to payments of fake profits to investors in excess of their investment and payments to sales agents for luring in new investors. In a Ponzi scheme, these sorts of transfers are made with the actual intent to delay, hinder or defraud creditors.

A Ponzi scheme is a criminal enterprise comprised of a series of intentionally fraudulent acts, including the acceptance of obligations to pay fictitious profits based on a fake business and the transfer of assets falsely represented to be profits. A Ponzi scheme is usually defined to be fraud that involves "funneling proceeds received from new investors to previous investors in the guise of profits from the alleged business venture, thereby cultivating an illusion that a legitimate profit-making business opportunity exists and inducing further investment."[13] When caught and convicted, the perpetrators can anticipate a lengthy jail sentence.

In many cases, there is direct evidence of fraudulent intent in the form of a plea by or conviction of the debtor. As the necessary intent is an element of the crime, no further proof is usually necessary.[14] Even without a conviction,

---

[10] *Id.* at § 4(a)(2)(i).

[11] *Id.* at § 4(a)(2)(ii).

[12] *Id.* at § 2(b).

[13] *Donnell v. Kowell*, 533 F.3d 762, 767 n.2 (9th Cir. 2008).

[14] *In re Slatkin*, 525 F.3d 805, 814 (9th Cir. 2008) (holding that the factual admissions in the debtor's plea bargain were sufficient to establish that payments in furtherance of the scheme were made with an actual intent to defraud); *also In re Randy*, 189 B.R. 425, 439–40 (Bankr. N.D. Ill. 1995) (using the factual allegations of the indictment after debtor's conviction to

evidence that the debtor operated a Ponzi scheme can establish the intent to defraud creditors, i.e., the investors.

> One can infer an intent to defraud future [investors] from the mere fact that a debtor was running a Ponzi scheme. 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. The perpetrator nevertheless makes payments to present investors, which by definition, are meant to attract new investors. He must know all along, from the very nature of his activities, that investors at the end of the line will lose their money.[15]

Stated another way, the debtor knows that each defrauded investor is entitled to his or her money back. By using that investor's money to pay false profits to another investor in order to maintain the illusion of legitimacy, the debtor is preventing the investor from learning of the fraud and ensuring that money will not be available to repay the investor.

Moreover, the factors that courts consider when determining whether a Ponzi scheme exists serve equally well as badges of fraud under UFTA particularly when addressing payments of false profits. In determining whether a Ponzi scheme has occurred, a court will often look at numerous factors, such as:

- The promise of an artificially high rate of return.[16]
- The absence of significant legitimate business operations.[17]
- Whatever legitimate business operations that did exist were insufficient to fund payments of returns to investors.[18]
- Misrepresentation as to enterprise's legitimate operations.[19]
- Use of investor funds to pay returns to other investors.[20]

---

establish circumstances showing the debtor's intent to defraud).

[15] *In re Independent Clearing House Co.*, 77 B.R. at 860; *also In re Randy*, 189 B.R. at 438–39 (Ponzi operator "necessarily knew all along that most investors, certainly the latest among them, would lose their money if they invested in his scheme").

[16] *In re LLS America LLC* (Bankr. E.D. Wash. July 1, 2013) ("The most common characteristic [of a Ponzi scheme] which appears to be almost invariable, is a promise of a high rate of return on the funds.").

[17] *In re Randy*, 189 B.R. at 437 n.17.

[18] *Gillman v. Geis (In re Twin Peaks Fin. Servs.)*, 516 B.R. 651, 655 (Bankr. D. Utah 2014).

[19] *Id.* at *5.

[20] *American Cancer Society v. Cook*, 675 F.3d 524, 528 (5th Cir. 2012) (describing the use

- Misrepresenting the source of the returns, i.e., telling investors the returns were from business operations when the returns were really just money taken from later investors.[21]
- The payment of high returns for the purpose of luring other investors into the scheme.[22]
- Commingling of investor funds.[23]
- Undertaking obligations in excess of the debtor's ability to repay them when the obligations come due.[24]
- Transfers are made without receiving reasonably equivalent value, i.e., the investor has no legal right to profits.[25]

While all are not expressly set out in UFTA, these factors are equally good indicia of fraud as those set out in the statute. Notably, the statutory badges of fraud are not exclusive and courts can, and should, consider other indicia of fraudulent intent.[26]

The analysis is even simpler when considering payments of commissions to sales agents. A Ponzi scheme cannot survive without a continual influx of new victims. By paying commissions to secure additional victims, the debtor is perpetuating his scheme and further delaying the day by which the investors will learn that they had been defrauded and demand their money back. This delay works in favor of the debtor's principals by allowing them additional time to skim assets from the scheme.

Ponzi Schemes Are Prospectively Insolvent for Purposes of UFTA from Inception

The second of the Ponzi presumptions is that the operator of the scheme is insolvent from inception. This particular presumption has often been criticized by courts and commentators as speculative. These critics often point to the lack of evidence of the debtor's assets and postulate that the debtor may have other assets not necessarily accounted for by the scheme.[27]

---

of investor funds to pay "returns" to other investors as the "*sina qua non* of any Ponzi scheme").

[21] *In re LLS America*, *supra*.

[22] *In re Provident Royalties*, 517 B.R. 687, 695 (Bankr. N.D. Tex. 2014).

[23] *In re LLS America*, *supra*.

[24] *Donell*, 533 F.3d at 770–71.

[25] *See infra*.

[26] *Ho*, 395 S.W.3d at 328.

[27] *E.g.*, *Finn*, 860 N.W.2d at 649.

These criticisms somewhat miss the point. They rely on UFTA's test for balance sheet insolvency. Balance sheet insolvency is not actually all that important in UFTA's statutory scheme. While a badge of fraud that may be considered when determining fraudulent intent, insolvency is neither sufficient nor necessary to show intent. It is not at all relevant to fraudulent transfers as to future creditors and it is only one of the three alternatives for showing fraudulent transfers as to present creditors. What really counts under UFTA are the two measures of prospective insolvency set out in Section 4(a)(2)—inadequate capitalization and taking on more debt that can reasonably be paid.

Although courts applying the Ponzi presumption of insolvency use the term "insolvency," they are actually referring to prospective insolvency under UFTA.[28] Prospective insolvency looks to the debtor's intent—did the debtor intend to incur debts beyond its ability to pay—not its current status.[29] The intent to incur debt well in excess of the ability to pay is inherent to a Ponzi scheme.[30] By definition, a Ponzi scheme obtains funds from investors based on false promises of large returns supported by the debtor's purported business operations. Instead of using income from business operations (which usually do not exist) to pay the promised returns, the debtor uses funds received from subsequent investors. These payments satisfy the original investor while providing the illusion of success necessary to attract new investors. The debtor, in turn will need additional investors to pay the second investor and so on. Because the pool of victims is not infinite, the scheme will inevitably collapse.[31] No one can rationally start a Ponzi scheme without expecting this result. All that UFTA requires for prospective insolvency is that the debtor intend to incur or reasonably should have believed that it would incur debts in excess of its ability to pay.

Payments of Profits to Investors and Commissions to Sales Agents are Transfers Without Equivalent Value

The third Ponzi presumption is that the payments to investors in excess of their investment (however described) and commissions to sales agents are without equivalent value. This is less of a presumption than a natural

[28] *E.g.*, *Donnel*, 533 F.3d at 770–71.

[29] UFTA, § 4(a)(2)(ii).

[30] *Conroy v. Shott*, 363 F.2d 90, 91–92 (6th Cir. 1966) (describing the need to attract ever increasing numbers of new contributions and associated obligations in order to keep a Ponzi scheme running).

[31] *In re Independent Clearing House Co.*, 77 B.R. at 860.

conclusion from illegal nature of the scheme. As its comments indicate, UFTA looks at the value exchanged for a questioned transfer in terms of its benefit to the creditors.[32] What this generally means is a determination of whether the value that the debtor received either maintains the debtor's assets (e.g., exchanging cash for property or paying to maintain other assets), reduces the debtor's debts or otherwise makes it more likely than not that the debtor will be able repay its creditors. Thus, payments to the debtor's owners, purchases of jewelry for the owner's mistress or payments of related entities' debts or expenses are generally considered not to have value.[33] In the ordinary context, this is not terribly controversial.

In the context of a Ponzi scheme, however, this basic proposition can be controversial because transactions that would otherwise appear to be legitimate turn out to be illegitimate and, thus, without value. The primary example of this is payments to investors in Ponzi schemes. Many would argue that the investors have a contractual right to their money back plus the agreed upon return. In ordinary circumstances, the satisfaction of an existing obligation is considered to be reasonable value to support a transfer in an equivalent amount. Yet, as a general matter, courts have held that payments to a Ponzi investor in excess of the amount that the investor contributed are fraudulent because they are in excess of any value given for them.[34] This apparently inconsistent treatment of the payments to investors gives the appearance that UFTA is applied differently in Ponzi schemes than in ordinary circumstances.

In actuality, courts applying this Ponzi presumption to payments of profits to investors utilize the same definition of value in both Ponzi scheme cases and ordinary cases. What is different is the legality and enforceability of the investors' contracts. This question, while important for UFTA's purposes, is not itself controlled by UFTA. Instead, it is controlled by common law principles regarding the enforceability of illegal contracts.

A Ponzi scheme is illegal. As a result, the contracts executed by the investors to invest in the scheme are illegal and generally unenforceable under general equitable principles.[35] This is so even for innocent investors. Even an innocent

---

[32] UFTA, § 3, cmt. 2 ("Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition" of value.).

[33] *Golf Channel III*, 2016 Tex. LEXIS 241 at *35–*36.

[34] *Janvey v. Brown*, 767 F.3d 430, 441–43 (5th Cir. 2014); *Donnel*, 533 F.3d at 771–72; *Scholes v. Lehman*, 56 F.3d 750, 757 (7th Cir. 1995).

[35] *Brown*, 767 F.3d at 441–43 (holding that the false certificates of deposit purchased by the investors were nothing more than illegal contracts that were void as against public policy and that ordinary principles of equity would not allow even innocent investors to enforce the certificates).

party cannot enforce an illegal contract if it would be inequitable to do so.

Allowing even an innocent investor to receive payments in excess of the investment would be inequitable. The Ponzi scheme lacks sufficient legitimate profits to satisfy its contractual obligations to its investors; instead the debtor uses money provided by subsequent investors to make payments. As the contract can only be fulfilled through the use of stolen funds, enforcing the contract would be inequitable.[36] In addition, the issue often arises in a proceeding where the trustee is attempting to make restitution to a large number of victims; some of whom have received payments and some of whom have not. In this circumstance, enforcing the contracts would further perpetuate the scheme resulting in additional inequities.[37] Because the investor's contract is not enforceable, the debtor has no obligation to make payments under it and thus, a payment to discharge the purported obligation is without value.

While lacking the right to enforce the investment contract, the investor has a restitution claim against the debtor. As a result, payments to the investor up to the amount of the investor's investment satisfy the debtor's restitution obligation. These payments are transfers for reasonably equivalent value. Payments in excess of the restitution obligation, however, are transfers for less than reasonably equivalent value.

A similar analysis applies to commission agreement with sales agents. No one is entitled to a commission on an illegal contract.[38] In many cases, such commissions are disallowed by state and federal securities law.[39] Moreover, luring more victims into an illegal scheme is not work that deserves compensation.[40]

---

[36] *In re Independent Clearing House Co.*, 77 B.R. at 857–58 (holding that it would be inequitable to allow even innocent investors to enforce contracts by which they invested in the scheme because the intended source of repayment were funds stolen from other investors).

[37] *Scholes*, 56 F.3d at 757 (holding that it would be inequitable to allow investors to enforce the contracts by which they invested in the scheme because it would lead to some investors benefiting at the expense of others which would be contrary to the equitable goals of the receivership).

[38] *In re Randy*, 189 B.R. at 441–43 (holding that contracts for sale of an illegal investment were illegal and not a lawful obligation of the debtor).

[39] *E.g.*, Tex. Rev. Civ. Stat. art. 581–34 (contracts for commissions on the unregistered sale of securities are not enforceable).

[40] *Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006) (explaining that "[i]t takes cheek to contend that in exchange for the payments he received, the RDI Ponzi scheme benefitted from his efforts to extend the fraud by securing new investments").

As the Law Has Developed and Trustees Have Become More Aggressive, the Ponzi Presumptions Have Broadened

In the very particular context of specific transactions within a Ponzi scheme, the Ponzi presumptions make sense and are supported by UFTA. As the case law has evolved over time, however, courts have begun to apply the Ponzi presumptions much more broadly. Trustees and receivers in turn have urged broader and broader application of the presumptions. To some extent, the Ponzi presumptions have taken on a somewhat talismanic quality. Once the debtor's underlying activity is declared to be a Ponzi scheme, all of the debtor's dealings are presumptively fraudulent transfers. Any transfer by a fraudster is per se fraudulent; not just those in furtherance of the fraud. And, the presumptions are not necessarily limited to Ponzi schemes.

While some courts still require a trustee to prove that a questioned transfer was in furtherance of a Ponzi scheme in order for the presumption of actual intent to defraud to apply, many do not. As a district court in Utah held, "once it is established that a debtor acted as a Ponzi scheme, all transfers by that entity are presumed fraudulent and can be avoided."[41] While, as discussed above, certain payments by an operator of a Ponzi scheme are indisputably necessary for the fraud to continue, not every transaction a fraudster enters into is necessarily fraudulent.

For example, the debtor's purchase of pens and paper at an office supply store would not ordinarily be considered fraudulent. This sort of routine, open-market, ordinary course of business transaction is not the type of transaction to which UFTA is targeted. That should not change simply because the debtor is also operating a Ponzi scheme. It is not sufficient to say that the debtor used those supplies to promote the scheme. The complaint there is not with purchase of office supplies, but with the debtor's use of those supplies; a factor not relevant to the transferee's liability under UFTA.

This trend reached its nadir in the Fifth Circuit's (now withdrawn) opinion in *Janvey v. Golf Channel, Inc.* ("*Golf Channel I*").[42] *Golf Channel I* arose out of Stanford International Bank's purchase of television advertising from the Golf Channel. Despite universal agreement that the purchase was at arm's length and that the price paid was a market price, the court held that the advertising was of no value to Stanford because it drew more victims to Stanford's scheme. As

[41] *Miller v. Kelley*, 2014 U.S. Dist. LEXIS 153319, at *8 (D. Utah 2014); *also Wing v. Dockstader*, 482 F. App'x 361, 363 (10th Cir. 2012) ("Under the UFTA, once it is established that a debtor acted as a Ponzi scheme, all transfers by that entity are presumed fraudulent.").

[42] 780 F.3d 641 (5th Cir.), *vacated by* 792 F.3d 539 (5th Cir. 2015) (per curiam).

a result, the Golf Channel failed, as a matter of law, to prove its affirmative defense that it had provided reasonably equivalent value in good faith to Stanford in exchange for the purchase price. Ultimately the Fifth Circuit withdrew its opinion in *Golf Channel I* and certified the question of value to the Texas Supreme Court.[43]

Golf Channel I and cases like it represent an over-extension of the Ponzi presumptions. The purchase of television advertising at issue falls far outside of the transactions for which the Ponzi presumptions were designed to deal. Accordingly, the rationale supporting them simply does not fit. While a court could (and, given the acknowledged facts of Stanford's scheme, probably must) conclude that Stanford was, at least, prospectively insolvent at all times relevant to its contractual relationship the Golf Channel, it is hard to see how the open market purchase of television advertising evidenced an intent to delay, hinder or defraud creditors. The contract itself was perfectly lawful.

While *Golf Channel I* arose out of a Ponzi scheme, it is emblematic of the pernicious effect that the Ponzi presumptions have had on fraudulent transfer law. While a useful analytical shortcut when dealing with specific transfers in Ponzi schemes, the presumptions are not at all helpful outside of their particular context. Their wide scale use has upset UFTA's balance of the rights of creditors against the rights of third parties who deal in good faith with debtors.

FACED WITH THE OVEREXPANSION OF THE PONZI PRESUMPTIONS, STATE COURTS HAVE QUESTIONED THE RATIONALE UNDERLYING THE PRESUMPTIONS LIMITING THEIR EFFECT

In the last year or so, the Minnesota Supreme Court and the Texas Supreme Court questioned the application and the propriety of the Ponzi presumptions. In each case, the court held that one or more of the Ponzi presumptions was not supported by UFTA at least in the cases before them. Neither case, however, dealt with a traditional Ponzi payment. Thus, these cases do not necessarily spell the death knell for the Ponzi presumptions. They do stand for the wholesale rejection of the talismanic effect of the Ponzi presumption.

The Minnesota Supreme Court acted first. In *Finn v. Alliance Bank*,[44] the Minnesota court reviewed the Ponzi presumptions in a case involving a fraudulent loan participation scheme. The debtor sold participations in loans

---

[43] *Janvey v. Golf Channel, Inc.*, 792 F.3d 539 (5th Cir. 2015) (per curiam) ("*Golf Channel II*").

[44] 860 N.W.2d 638 (Minn. 2015).

that it had originated. The participations were structured so that the borrower paid the debtor who would then in turn pay the participating investors. In most cases, the loans either did not exist or were intentionally oversubscribed by the debtor.[45] In a few cases, however, the debtor entered into a legitimate transaction selling only 100 percent of a loan to an investor.[46] The transactions at issue in *Finn* were a mix of legitimate and fake loan participations.[47]

The receiver sued Alliance Bank and a number of other banks to recover payments made to them under their loan participation agreements. The participation agreement to which Alliance Bank was a party was one of the few legitimate agreements. The remaining banks were parties to either fictitious or oversubscribed participation agreements. Each bank received payments in excess of the amount that it had invested.[48]

The receiver's pleadings relied heavily on the Ponzi presumptions generally alleging that because the debtor was operating a Ponzi scheme the transfers to the banks were made with actual intent, that the debtor was prospectively insolvent and that the debtor received no value in exchange for the payments to the banks. The trial court granted summary judgment in favor of the receiver on his claim against Alliance relying on the Ponzi presumptions but dismissed his claims against the other banks on limitations.[49]

The court of appeals held that the Ponzi presumptions of fraud and insolvency were supported by UFTA but that the presumption that payments to investors were without value was not. Accordingly, it reversed and rendered judgment in favor of Alliance Bank holding that because Alliance's participation was a valid obligation the payments it received were not fraudulent transfers. The court of appeals found for the receiver on limitations. It also held that the receiver had properly pled that the transfers to the other banks were either made with actual intent to defraud or that the debtor was constructively insolvent but that the receiver had failed to adequately plead the lack of reasonably equivalent value with regard to his constructive fraud claims.[50]

The Minnesota Supreme Court affirmed. In so doing, it analyzed and largely rejected each of the Ponzi presumptions. One of the more notable aspects of *Finn* is that the court viewed the Ponzi presumptions as conclusive and

[45] *Id.* at 642.

[46] *Id.*

[47] *Id.* at 643.

[48] *Id.*

[49] *Id.*

[50] *Id.*

applicable to all of the debtor's transactions simply upon finding that a Ponzi scheme existed, which is contrary to the traditional understanding of the presumptions. Whether this was a reflection of the expanded use of the presumptions or simply how the receiver argued his case, the court's views on this point had a significant impact on its analysis.

The *Finn* court began by noting that the UFTA does not expressly provide for the presumptions.[51] It then turned to the three Ponzi presumptions: (1) that fraudulent intent accompanies all transfers: (2) that the debtor is insolvent; and (3) that the debtor cannot receive reasonably equivalent value for the "interest" or "profits" it pays to investors. Ultimately, the court held that none of these presumptions were supported by UFTA, at least applied conclusively and mechanically.

The *Finn* court first rejected the presumption that all transfers made in furtherance of a Ponzi scheme are made with fraudulent intent. The court reasoned that UFTA does not allow a court to simply presume fraudulent intent. Instead, it requires that a court determine whether the intent behind a given transfer was fraudulent by examining UFTA's statutory badges of fraud. To the court, the existence of a Ponzi scheme is just a badge of fraud to be considered by a court in connection with other factors relating to a specific transfer. As such, the existence of a Ponzi scheme cannot be conclusive as to whether fraudulent intent was present in any given transfer related to that scheme.[52]

The court did, however, hold that a "court could make a 'rational inference' from the existence of a Ponzi scheme that a particular transfer was made with fraudulent intent."[53] What the court held was improper was a conclusive presumption that all transfers were made with fraudulent intent. Instead, the court would determine intent in light of the facts and circumstances of each transfer.[54]

The court then turned to the presumption of insolvency. Here the court simply refused to accept that all Ponzi schemes (or perhaps, all schemes subsequently labelled as "Ponzi schemes") are necessarily insolvent from day one.[55] The court gave as examples, apparently based on the case before it, the

---

[51] *Id.* at 647 ("The word 'Ponzi' does not appear in the Minnesota Statutes and MUFTA does not address 'schemes.'").

[52] *Id.*

[53] *Id.* at 647.

[54] *Id.*

[55] *Id.* at 648–49.

debtor that began as a legitimate business and turned to fraud and the debtor whose business is a mix of legitimate and fraudulent. In either case, the court reasoned that it would be improper to presume that the debtor was always insolvent.[56]

Finally, the court rejected the presumption that payment of profits or interests on Ponzi investments lack value to the transferor. The court noted that courts that apply the Ponzi presumption effectively deem the contract between the investor and the operator of a Ponzi scheme to be unenforceable. By so doing, the courts eliminate the right of the investor to payment of interest or profits.[57] The *Alliance Bank* court reasoned that two principles guide the reasoning of courts that have concluded that investor contracts in Ponzi schemes should not be honored. It found neither principle convincing on the facts before it.

The first principle relied on by courts that apply the Ponzi presumption is that there are no legitimate profits in a Ponzi scheme. Payments of "profits" are really nothing more than the redistribution of stolen funds from one victim to another. While the *Finn* court recognized that in many Ponzi schemes the payment of "profits" has no legitimate basis and confers no benefit on the debtor, the court held that this was not necessarily so. Some Ponzi schemes may have a legitimate source of earnings. Thus, the court held that an investor's contract could not be set aside merely because it had been entered into as part of a Ponzi scheme.[58]

The second principle relied upon by courts willing to adopt the Ponzi presumption is that the purpose of the fraudulent transfer laws is to equally distribute the assets of a Ponzi operator among its victims. The *Finn* court rejected this principle as directly contrary to the purpose and express language of the UFTA. The court held that the purpose of the UFTA is to prevent debtors from placing property out of the reach of creditors; not to insure that all creditors are treated equally or even equitably.[59] Rather than demanding that creditors be treated equally, UFTA expressly allows a debtor to prefer one creditor over another so long as the preferred creditor is owed a legitimate debt.

The *Finn* court's reasoning on this point is suspect. UFTA and its goals have nothing to do with whether the investors can enforce their contracts. UFTA requires obligations to be lawful but does not determine which obligations are

---

56 *Id.*

57 *Id.* at 651.

58 *Id.* at 652.

59 *Id.* at 652.

lawful. That determination is governed by other law, in this instance by equitable *in pari delicto* principles.

The *Finn* court skipped a step in its analysis. The investors' contracts are unlawful because they are contracts to participate in an illegal venture—the Ponzi scheme. Legally, they are presumed to be unenforceable unless the party seeking to enforce the contract is innocent and can establish that equity supports enforcing the contract. The concerns about the lack of legitimate funds and equitable distribution of assets among equally defrauded victims, which the *Finn* court rejected in light of UFTA, arise in the context of the court's decision whether to allow an innocent investor to enforce an illegal contract—a decision on which UFTA does not provide the rule of decision.

Because the receiver had apparently provided nothing more than evidence that the Ponzi scheme occurred and that the payments to Alliance were during the course of the scheme, the *Finn* court held that Alliance had established, as a matter of law on summary judgment, that it provided reasonably equivalent value (in the form of the elimination of a valid obligation) in exchange for the payments it received from the debtor.[60] Interestingly, however, the *Finn* court also held that the receiver had sufficiently pled that the transfers to the other banks which had participated in the fake transactions were made with actual intent to defraud. Those allegations were largely that a Ponzi scheme had occurred, the debtor's principal had pled guilty admitting that he intended to defraud the banks and itemization of a series of fictitious or oversubscribed participation agreements. It also held, based on the same allegations, that the receiver had alleged that the debtor was constructively insolvent at the time of the transfers.[61]

The next blow was struck about a year later by the Texas Supreme Court in *Janvey v. Golf Channel* ("*Golf Channel III*").[62] The *Golf Channel* cases arise out of the Stanford Ponzi scheme, which the Texas Supreme Court termed "one of the most notorious Ponzi schemes of the modern era."[63] As part of a marketing initiative, Stanford International Bank entered into a sponsorship and advertising contract with the Golf Channel. For two years, Stanford sponsored a PGA golf tournament and purchased related advertising. For these services, Stanford paid $5.9 million.

After the Ponzi scheme was exposed and Stanford entities placed into

[60] *Id.* at 655–56.

[61] *Id.* at 654–55.

[62] *Janvey v. Golf Channel, Inc.*, 487 S.W.3d 560, 2016 Tex. LEXIS 241 (Tex. 2016).

[63] *Id.* at *3.

receivership, the receiver sued to recover the entire $5.9 million payment as a fraudulent transfer under Texas' version of UFTA. Relying on the Ponzi presumptions, the receiver argued that Stanford's payments to the Golf Channel were made with an actual intent to defraud and that the advertising services provided were of no value to Stanford. The Golf Channel conceded that the payment was made with the intent to defraud but argued that its advertising services had a significant, objective market value equal to at least the payments it had received. Both parties agreed that the Golf Channel acted in good faith.

In its initial opinion, the Fifth Circuit agreed with the Receiver. It reasoned that, for the purposes of UFTA, the value exchanged for a transfer must be analyzed from the perspective of the debtor's creditors. Accordingly, only those goods and services that increased, maintained or had the potential to increase the debtor's net worth created value from the creditor's perspective.[64] Relying on a line of cases dealing with commissions to sales agents, the Fifth Circuit held that adding new investors to a Ponzi scheme only worsened its insolvency and, thus, was of no value to the creditors.[65] On rehearing, the Fifth Circuit certified the question of value to the Texas Supreme Court.[66]

The Texas Supreme Court rejected the Fifth Circuit's analysis of value, which it viewed as subjective and retrospective, as inconsistent with UFTA. Instead, the court held that UFTA requires "an objective inquiry that considers the existence of value—or utility of consideration—from a reasonable creditor's perspective at the time of the transaction."[67] Thus, value exists when the debtor took consideration that had objective value at the time of the transfer even if the consideration neither preserved the debtor's solvency nor generated an asset that could be seized by creditors.[68]

While value requires that the debtor receive some objective economic benefit, it does not require that the transferred asset be replaced with money or some other tangible asset that can be sold to satisfy creditor's claims. Otherwise, value would effectively exclude consideration in the form of consumable goods (food, utilities, office supplies, or internet services) or the repayment of debt.[69] Nothing in UFTA's language supports such a narrow and limited definition of value.

---

[64] *Golf Channel I*, 780 F.3d at 645.

[65] *Id.* at 645–46.

[66] *Janvey v. Golf Channel, Inc.*, 792 F.3d 539 (5th Cir. 2015) (per curiam) ("*Golf Channel II*").

[67] *Golf Channel III*, 2016 Tex. LEXIS 241 at *41.

[68] *Id.* at *42.

[69] *Id.* at *38.

Such a limited definition of value would also lead to absurd results. Assume that an insolvent debtor spent $3 at a grocery store to purchase a case of bottled water for its employees to drink while working. This transaction would not improve the debtor's solvency as the water would be consumed and, thus, unavailable to the creditors. The $3 is gone forever. No one would consider this transaction to be a fraudulent transfer, however. Yet, under the analysis of *Golf Channel I*, this transaction would be fraudulent transfer unless courts were to speculate that hydration by bottled water as opposed to tap water increases employee productivity—an unseemly way to define value.[70]

Having rejected the Fifth Circuit's analysis in the context of an ordinary fraudulent transfer case, the *Golf Channel III* court next considered whether there was something unique to Ponzi schemes that would require a different definition of value for purposes of UFTA. The court reviewed *Finn* as well as a number of federal cases involving fraudulent transfers in Ponzi. Based on its review, the court noted that even in Ponzi scheme cases, the better reasoned cases focused on the objective value of the good or services exchanged rather than the impact the goods or services had on the debtor's estate. Thus, the court agreed with *Finn* that otherwise legitimate transactions are not rendered illegitimate simply because one party to the transaction was otherwise engaged in illegal conduct. The *Golf Channel III* court did, however, acknowledge that a great many of the transfers at issue in Ponzi scheme cases were payments for illegal services or on illegal contracts and that the value inquiry would turn on whether the consideration provided was legal.

The Texas Supreme Court ruled in favor of Golf Channel holding that the value given in exchange for a questioned transfer must be viewed from the perspective of an objective creditor without the benefit of hindsight.[71] The court created the following test for determining value under UFTA:

> [UFTA'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

[70] *Id.* at *18 (noting that the Fifth Circuit engaged in just this sort of speculation regarding electrical service).

[71] Texas' version of UFTA defines "reasonably equivalent value" as a transfer "that is within the range of values for which the transferor would have sold the assets in an arm's length transaction." TEX. BUS.& COMM. CODE § 24.004(d). This definition is not found in UFTA generally and has not been adopted by any other state. *Golf Channel III*, 2016 Tex. LEXIS 241 at *32. Nevertheless, the court did not appear to accord this unique aspect of Texas law much weight as Texas had adopted UFTA's definition of value in its entirety. *Id.* at *32–*40.

the exchange in the ordinary course of the transferee's business.[72]

The court further held that there was nothing inherent in Ponzi schemes that called for a different definition of value. Accordingly, Stanford's use of the Golf Channel's concededly lawful services for illicit purposes was irrelevant for UFTA's purposes.[73]

The Ponzi presumptions of insolvency and fraud were not before the Texas court in *Golf Channel III*. Nevertheless, the court's favorable citation of *Finn* and the reasoning of the opinion suggest that the Texas Supreme Court is likely to recognize the Ponzi presumptions in a very limited form, if at all. Indeed, while reciting that the question of the Ponzi presumption of fraud was not before it, the court noted that the Ponzi presumption could not be found in the text of the statute.[74]

UFTA FOLLOWING *FINN* AND *GOLF CHANNEL*

Taken together *Finn* and *Golf Channel III* represent a repudiation of the expansive use of the Ponzi presumptions by the federal courts. They make it abundantly clear that, at least in Texas and Minnesota, not every transfer by a debtor operating a fraudulent scheme (or even a Ponzi scheme) may be presumed to be made with fraudulent intent. It is equally clear that a receiver or trustee cannot simply invoke the Ponzi presumptions to avoid burdens of proof that would otherwise apply. Not that this was ever truly the case.

Nothing in either *Finn* or *Golf Channel III* suggest that the Ponzi presumptions should not continue to apply in their traditional context. Once a fraudster develops the intent to engage in a Ponzi scheme, courts can presume that the fraudster intends to defraud his creditors and that transfers as part of that scheme are fraudulent. Similarly, courts should continue to hold that those who induce victims into Ponzi (or other fraudulent) schemes and those investors who profited from an illegal scheme should not be allowed to retain their ill-earned gains.

Trustees and receivers seeking to recover payments out of fraudulent schemes must continue to gather and put forth evidence of the fraudulent nature of the scheme as well as its actual and prospective insolvency. They also need to focus

---

[72] *Golf Channel III*, 2016 Tex. LEXIS 241 at *7.

[73] *Id.* at *55 ("The value inquiry may turn on whether the consideration provided to the debtor was illegal, but the value of services or goods provided to a debtor does not hinge on whether a debtor utilizes services or goods to further an illegal scheme or to pursue a legitimate business endeavor.").

[74] *Id.* at *15 n.27.

on the facts of the questioned transfer and how it fits into the overall scheme. This should not be a difficult burden. In cases where the Ponzi presumption would otherwise apply, evidence sufficient to support all of the traditional elements of a fraudulent transfer should be prevalent. In short, *Finn* and *Golf Channel III* serve as a reminder to all who practice in this field that facts and evidence matter and that there are no shortcuts.