RECEIVERS' FRAUDULENT TRANSFER CLAIMS IN PONZI SCHEME CASES

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Everyone who has intentionally or unwittingly played a role in a Ponzi scheme may become the target of litigation when a Ponzi scheme comes unraveled and ends up in a receivership action commenced by the Securities and Exchange Commission or other regulatory agency. Investors, sales people, officers, directors, attorneys, accountants, auditors, financial institutions, and even charitable organizations are all possible targets of litigation. All can be completely deceived in a Ponzi scheme, and yet all can find themselves as defendants in serious litigation.

In the quest to recover funds for the benefit of defrauded investors, receivers look to recover funds and other assets transferred to net winner investors and others who can return funds to the estate to help make defrauded investors whole.

A Ponzi scheme is a fraudulent enterprise run under the pretense of a legitimate profit-making business. Investments are solicited, often by broker-dealers, from new investors, and those funds are then used to pay earlier investors. That, of course, induces further investments. All the while, the Ponzi scheme operator siphons off a substantial part of the funds for personal use. The scheme is destined to fail and then frequently lands in a receivership proceeding.

As a Ponzi scheme progresses, the earlier investors are often paid back more money than they invested, receiving the fictitious profits that they were promised. These investors are often referred to as "net winners." Broker-dealers are often paid handsome commissions for soliciting the investments. Well-known lawyers and accountants are often engaged to add an air of legitimacy to the fraudulent enterprise. Banks do favors for their customers, or run millions of dollars of stolen investor funds through their accounts without investigation. When the Ponzi scheme fails and it is time to unwind the tangled financial web, the receiver then considers seeking recovery of: (1) the funds transferred to the investors (both principal repayments and

fictitious profits); (2) commissions paid to the sales people and broker-dealers who solicited the investments for the Ponzi scheme debtor; (3) transfers made to friends and family; (4) donations made to charitable organizations; and (5) fees paid to attorneys, auditors or other professionals.

To "claw back" the transfers that the Ponzi scheme debtor made to investors, sales people, friends, family, or others, a receiver commonly uses the fraudulent transfer laws available under applicable state law. Claw back claims can be based on either of two theories – actual intent to hinder delay or defraud creditors, or constructive fraudulent transfers.

I. Actual Fraudulent Intent

For a claim to recover a transfer made with actual fraudulent intent, most if not all state statutes authorize a receiver to avoid a transfer of the debtor's property made with the "actual intent to hinder, delay or defraud" any current or future creditor. Either the Uniform Fraudulent Transfer Act ("UFTA"), which replaces the Uniform Fraudulent Conveyance Act ("UFCA"), or the UFCA have been adopted by almost all states.

In a Ponzi scheme case, there are a few different methods that can be used to establish the necessary fraudulent intent. With a Ponzi scheme comes a unique presumption in connection with fraudulent transfer laws. Where a Ponzi scheme has been proven, there is a presumption that transfers made by a Ponzi scheme debtor were made with the actual intent to hinder, delay or defraud creditors, which is sufficient to establish the claim to recover the transferred funds. *See, e.g., Donell v Kowell,* 533 F.3d 762, 770 (9th Cir. 2008); *see also Barclay v. Mackenzie* (*In re AFI Holding, Inc.*), 525 F.3d 700, 704 (9th Cir. 2008) ("[T]he mere existence of a Ponzi scheme is sufficient to establish actual intent" to hinder, delay or defraud"); *Wing v. Gillis*, 2012 U.S. Dist. LEXIS 39638, at *5 (C.D. Utah Mar. 22, 2012).

Courts have found that to establish a Ponzi scheme, a plaintiff must establish: "(1) deposits were made by investors; (2) the Debtor conducted little or no legitimate business operations as represented to investors; (3) the purported business operations of the Debtor produced little or no profits or earnings; and (4) the source of payments to investors was from cash infused by new investors." *Rieser v. Hayslip, et al.* (*In re Canyon Sys. Corp.*), 343 B.R. 615, 630 (Bankr. S.D. Ohio 2006).

If a Ponzi scheme cannot be conclusively established, then a plaintiff may try to establish actual fraudulent intent through a more customary "badges of fraud" analysis using circumstantial evidence. The Uniform Fraudulent Transfer Act[2] provides a non-exclusive list of badges of fraud as follows: (1) the transfer was to an insider; (2) the debtor retained possession or control of the property transferred after the transfer; (3) the transfer or obligation was not disclosed or concealed; (4) before the transfer or obligation was made or obligation was incurred, the debtor was sued or threatened with suit; (5) the transfer was of substantially all of the debtor's assets; (6) the debtor absconded; (7) the debtor removed or concealed assets; (8) the value of the consideration received by the debtor was [not] reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (11) the debtor had transferred the essential assets of the business to a lienor who had transferred the assets to an insider of the debtor. *See also In re Lull*, 386 B.R. 261, 270 (Bankr. D. Haw. 2008) (actual intent may be established where transfer wears a sufficient number of badges of fraud).

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[2] UFTA § 4(a)(1) lists "badges of fraud"; however, UFTA § 4 states that the presence of one or more of the enumerated factors is evidence relevant to the debtor's intent, but does not create a presumption that a fraudulent transfer was made.

Alternatively, a plaintiff can establish fraudulent intent by relying on an admission of the debtor, usually in a criminal plea agreement, or if the debtor is found criminally liable for fraud. *See, e.g.*, *Santa Barbara Capital Management v. Neilson* (*In re Slatkin*), 525 F.3d 805, 814 (9th Cir. 2008) ("a debtor's admission, through guilty pleas and a plea agreement admissible under the Federal Rules of Evidence, that he operated a Ponzi scheme with the actual intent to defraud his creditors conclusively establishes the debtor's fraudulent intent under 11 U.S.C. § 548(a)(1)(A) and California Civil Code § 3439.04(a)(1), and precludes relitigation of that issue").

II. Constructive Fraud

Under a constructive fraud theory, the receiver must establish that the Ponzi debtor did not receive reasonably equivalent value in exchange for the transfers and that the Ponzi debtor was then insolvent or became insolvent as a result of the transfer. *See, e.g.,* Cal. Civ. Code §3439.04(a)(2). A split of authority exists as to the analysis and meaning of 'reasonably equivalent value' in a Ponzi case relating to payments made to investors and whether those payments were a return of principal or fictitious profits.

A. Issues Pertaining to Investors

Courts have critically distinguished between a transfer that was a return of the principal investment and a transfer that was a profit or "interest" paid in addition to the return of principal. The Ninth Circuit has held that, "Under the constructive fraud theory, the receiver may only recover 'profits' above the initial outlay, unless the receiver can prove a lack of good faith, in which case the receiver may *also* recover the amounts that could be considered return of principal." *Donell v. Kowell*, 533 F.3d 762, 771 (9th Cir. 2008). Most courts find that a transfer

to an investor as a return of principal is not recoverable because the transfer partially or fully extinguishes the investor's restitution claim against the debtor (assuming the subjective good faith of the investor). *Barclay v. Mackenzie* (*In re AFI Holding, Inc*.), 525 F.3d 700, 704 (9th Cir. 2008); *Perkins v. Haines*, 661 F.3d 623 (11th Cir. 2011).

However, there is a sharp split of authority over the issue of whether the payment to an investor of "interest" or "profits" on its investment was made in exchange for reasonably equivalent value. Some courts find that profits paid to an investor are recoverable as no value could be provided in exchange for the transfer which was made in a fraudulent scheme. *Merrill v. Abbott* (*In re Independent Clearing House Co*.), 77 B.R. 843, 858 (D. Utah 1987) ("To allow an [investor] to enforce his contract to recover promised returns in excess of his [investment] would be to further the debtor's fraudulent scheme at the expense of other [investors]"); *see also Scholes v. Lehmann*, 56 F.3d at 757 ("A profit is not offset by anything; it is the residuum of income that remains when costs are netted against revenues. The paying out of profits . . . conferred no benefit on the [debtors] but merely depleted their resources faster.").

On the other hand, some courts have placed their focus not on public policy or an analysis of equity, but rather on the contractual relationship between the investor and the debtor. *See Lustig v. Weisz & Assoc., Inc*. (*In re Unified Commercial Capital, Inc*.), 260 B.R. 343, 350 (Bankr. W.D.N.Y. 2001) (finding that debtor's use of investor's funds for a period of time supported the payment of reasonable contractual interest; courts cannot ignore what is clearly value and fair consideration under the fraudulent conveyance statutes).

The debate turns to whether "value" can be provided for profits. The *Independent Clearing House* line of cases finds that the only value was to perpetuate the Ponzi scheme, and no value can be provided if the contract underlying the transaction is illegal. The *Unified*

Commercial line of cases looks at the discrete transaction, finding that the court must measure what was given against what was received in that particular transaction, and concluding in some instances that the debtor's use of the investor's funds for a period of time supported the payment of reasonable contractual interest. *Unified Commercial Capital*, 260 B.R. at 351.

B. Issues Pertaining to Sales People

A transfer that the Ponzi debtor makes to a sales person as a commission is also potentially recoverable. However, the courts are split on the question of reasonably equivalent value relative to broker's commissions as well, and a receiver's success in recovering a commission depends on the case law in the jurisdiction in which the claim is brought.

Some courts have found that because a Ponzi enterprise has no legitimate purpose, there can be no value provided by a broker in furthering or assisting the debtor in perpetrating the fraud. Therefore, the commissions paid to the broker are recoverable by a receiver. *See, e.g., Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006) ("It takes cheek to contend that in exchange for the payments he received, the [debtor's] Ponzi scheme benefited from his efforts to extend the fraud by securing new investments."); *see also Steed v. Hawkins* (*In re Rivas*), 2012 Bankr. LEXIS 1482, at *17, n. 6 (Bankr. D. Tenn. Apr. 6, 2012).

Other courts have looked more narrowly at the relationship between the debtor and the broker and measure "what was given and received" by the debtor and the broker. These courts compare market commission rates with what was paid. As one court observed, "Money is valuable even when used for illegal purposes." *In re First Commercial Man. Group, Inc*., 279 B.R. 230, 237 (Bankr. N.D. Ill. 2002). This line of cases finds that value can be found in certain circumstances and the court must evaluate the consideration exchanged by the debtor and

transferee in the specific transaction which is sought to be avoided, not the transaction's impact on the debtor's overall business. *In re Churchill Mortgage Inv. Corp*., 256 B.R. 664, 680 (Bankr. S.D.N.Y. 2000).

C. Issues Pertaining to Charitable Organizations

Courts have found that no value was exchanged for a charitable contribution and, as such, the contribution was recoverable as a constructively fraudulent transfer. *See Scholes v. Lehman,* 56 F.3d 750, 761 (7th Cir. 1995) ("The statute makes no distinction among different kinds of recipient of fraudulent conveyances").

Additionally, in several Ponzi cases, the courts found that the perpetrator's charitable donations were made with actual fraudulent intent. *See, e.g., Hecht v. Malvern Preparatory School*, 716 F. Supp. 2d 395, 400 (E.D. Pa. 2010); *see also Liebersohn v. Campus Crusade for Christ, Inc.* (*In re C.F. Foods, L.P.*), 280 B.R. 103, 111-12 (Bankr. E.D. Pa. 2002) (debtor's payments of $1.7 million to charities during the four years prepetition were made as part of the fraudulent scheme to impress investors that the debtor was a profitable and charitable enterprise, and were therefore made with intent to defraud).

The recent case of *The American Cancer Society v. Cook*, 675 F.3d 524 (5th Cir. 2012), demonstrates the need for specific evidence when attempting to prove a Ponzi scheme to establish the element of actual intent to defraud in a fraudulent transfer action. In a case arising from the fraudulent scheme of Giant Operating, Inc., the receiver sought to recover $240,000 that the perpetrators paid to The American Cancer Society. The district court relied on the Ponzi presumption, as permitted by the Fifth Circuit in *Warfield v. Byron*, 436 F.3d 551, 558-59 (5th Cir. 2006), and found that the payments to The American Cancer Society were recoverable as

fraudulent transfers. It found that because defendants were operating a "Ponzi-like scheme," the debtors' transfers to the charity were "presumptively made with fraudulent intent." *SEC v. Harris*, 2010 U.S. Dist. LEXIS 99118 (N.D. Tex. Sept. 7, 2010), *Magistrate's report and recommendation adopted*, 2010 U.S. Dist. LEXIS 99146 (N.D. Tex., Sept. 22, 2010). However, the Fifth Circuit reversed, holding that the evidence did not support a "Ponzi scheme finding" because the receiver's affidavit, on which the district court had relied, was conclusory and insufficient. The court further found, "Nothing in [the receiver's] documents demonstrates that investor funds were used to issue 'returns' to other investors - a *sine qua non* of any Ponzi scheme." 675 F.3d at 528.

Earlier this year, Minnesota adopted a new law intended to provide additional protections to charities in fraudulent transfer actions. The new law was effective on April 3, 2012, and applied to all existing actions. Specifically, it amends Minn. Stat. § 513.41 to reduce the look-back period from 6 years to 2 years on fraudulent transfer claims against charities. The law also limits recoveries from charities as follows:

> A transfer of a charitable contribution to a qualified charitable or religious organization or entity is not considered a [constructive] transfer . . . if the amount of that contribution did not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution was made; or the contribution exceeded that amount but the transfer was consistent with practices of the debtor in making charitable contributions.

Id. This change precisely mirrors the limitation on recoveries against charities in § 548(a)(2) of the Bankruptcy Code.

In *Kelley v. College of St. Benedict*, 2012 U.S. Dist. LEXIS 153802 (D. Minn. Oct. 26, 2012), the receiver in the Petters Ponzi scheme case sought recovery of $2 million in contributions that Petters made to the defendant. Because the new law in Minnesota was

retroactive, it applied to the receiver's claims even though he filed his suit before the law took effect. The challenged transfers were more than two years before the receiver filed suit, so the law clearly precluded the fraudulent transfer claim. The court also rejected the receiver's attempt to circumvent the new law by pursuing a claim under the Federal Debt Collection Procedures Act and an unjust enrichment claim.

III. Good Faith Value Defense

Under either an actual fraudulent intent theory or a constructive fraud theory, the good faith of the investor-transferee is relevant, assuming value was provided, in establishing a partial or complete defense, depending on the circumstances. Most state statutes[3] create an exception for the transferee or obligee who takes the property in good faith and for value. *See, e.g.*, Cal. Civ. Code § 3439.08(a).

The analysis regarding whether value was provided for purposes of a good faith value defense is essentially the same as a reasonably equivalent value analysis on the receiver's prima facie case. *Barclay v. Mackenzie* (*In re AFI Holding, Inc.*), 525 F.3d 700, 707 (9th Cir. 2008). The *AFI* court reasoned:

> We find no reason, in statute or case law, to treat 'reasonably equivalent value" differently for each of the Code provisions [§§ 548(a)(1)(B) and 548(c)]."). For example, assume the trustee is successful on the basis of lack of reasonably equivalent value in setting aside the transfer of $200,000 to an investor from the Ponzi debtor, but that the investor has originally invested $100,000 of principal, and the investor did so in good faith. Because of the operation of section 548(c), the investor will only be required to return $100,000 of the transfer made since the $100,000 original investment will constitute value for purposes of section 548(c). Even though the investor may have been deprived of the benefit of the favorable bargain it had struck with debtor, it will have at least been compensated for the amount of its original investment.

[3] Most state statutes are similar to section 548(c) of the Bankruptcy Code.

The focus of a court's inquiry regarding good faith centers around the state of mind of the transferee - whether the transferee has knowledge of the debtor's insolvency or fraudulent activity; whether that knowledge is actual or constructive, and whether the transferee should have been placed on inquiry notice. Most courts consider whether the transferee objectively knew or should have known of the debtor's fraudulent purpose in making the transfer. *See, e.g., In re Agricultural Research and Technology Group, Inc.*, 916 F.2d 528, 535 (9th Cir. 1990). The knowledge and intent of a transferee are not factors in the prima facie fraudulent transfer action, whether based on actual or constructive fraud, but become quite relevant as transferees attempt to assert defenses.

In evaluating good faith, courts consider: (1) whether the transferee has knowledge of the debtor's insolvency or fraudulent activity; (2) whether that knowledge is actual or constructive; (3) whether the transferee should have been placed on inquiry notice of the fraudulent scheme or the insolvency of the debtor; and (4) what type of investigation was conducting after the transferee was placed on inquiry notice.

A. Actual Knowledge

If the investor had actual knowledge of the fraudulent scheme, a finding of good faith is generally precluded. *See, e.g., Indep. Clearing House*, 77 B.R. at 861 ("Certainly, if a defendant knew that the debtor was running a Ponzi scheme when he advanced money to the debtor or knew of the debtor's insolvency at the time of the allegedly fraudulent transfer, that knowledge might indicate a lack of good faith.").

B. Inquiry Notice of Fraudulent Scheme

If the circumstances would place a reasonable person on inquiry of the fraudulent scheme, then good faith is generally not found. *Jobin v. McKay* (*M & L Business Machine Co.*),

84 F.3d 1330, 1338 (10th Cir. 1996). Most courts have found that inquiry notice exists if there were red flags regarding the purpose of the transfer, the underlying fraud of the Ponzi scheme, the unfavorable financial condition of the transferor, the insolvency of the transferor, the improper nature of a transaction, or the voidability of the transfer. *Plotkin v. Pomona Valley Imports* (*In re Cohen*), 199 B.R. 709, 719 (B.A.P. 9th Cir. 1996) ("Such inquiry notice suffices on the rationale that some facts suggest the presence of others to which a transferee may not safely turn a blind eye"). The district court in the Southern District of New York made the standard more stringent, thereby making it harder to establish good faith, where a defendant is on inquiry notice of some "infirmity in the debtor or integrity its management." *In re Bayou Group, LLC,* 396 B.R. 810, 848 (S.D.N.Y. 2008).

Some of the factors which have been found sufficient to constitute "red flags" putting an investor on inquiry notice are:

1. Exorbitant Promised Rates of Return

A promise of very high or exorbitant returns should put an investor on inquiry notice. *See*, *e.g.*, *Jobin v. Lalan* (*In re M&L Bus. Mach. Co.*), 160 B.R. 851, 859 (Bankr. D. Colo. 1993), *aff'd* 167 B.R. 219 (D. Colo. 1994) (a Ponzi-scheme investor did not act in good faith in pursuing a supposedly risk-free investment promising profits of 125 percent to 512 percent); *Scholes v. Lehmann*, 56 F.3d at 760 (A debtor's promise of exorbitant rates of return should put an investor on inquiry notice: "Only a very foolish, very naïve, very greedy, or very Machiavellian investor would jump at a chance to obtain a return on his passive investment of 10 to 20 percent a month . . . It should be obvious that such returns are not available to passive investors in any known market, save from the operation of luck.").

2. Suspicious Circumstances Can Cause Inquiry Notice

If the circumstances would place a reasonable person on inquiry notice and a diligent inquiry would have uncovered the fraud, then a finding of a lack of good faith will likely be made. *Agric. Research*, 916 F.2d at 539 ("[I]f the circumstances would place a reasonable person on inquiry of a debtor's fraudulent purpose, and diligent inquiry would have discovered the fraudulent purpose, then the transfer is fraudulent"); *McKay*, 84 F.3d at 1338-39 (implausible explanation by company officials as to how they could pay such high rates places investor on inquiry notice).

3. The Investor's Level of Business Knowledge and Experience

An investor's education and experience can preclude a finding of good faith. *See, e.g., McKay*, 84 F.3d at 1333 (No good faith finding where investor attended college for three years, studied business administration and bookkeeping, operated his own construction business, a commercial and industrial real estate business, served as co-trustee for a family trust with assets in excess of $3,000,000, and owned a personal portfolio including a variety of stocks, bonds, mutual funds, raw land and promissory notes).

C. The Type of Due Diligence Made by the Investor

If insufficient due diligence was done by the investor, then good faith may not be found. Good faith will not be found under § 548(c) where the investor "ignored his own initial intuition and plunged headlong into scam because of the huge profits he was promised, and which he received." *Lalan*, 160 B.R. at 859. The *Lalan* court considered the following factors in finding the investor was not in good faith:

> Lalan did not ask to see any of the alleged contracts he was investing in; did not ask for financial records; did not ask about assets and liabilities of the Debtor; and did not ask who the

> accountants were for the Debtor. He did not ask for any written financial information. Whenever he did ask Joseph any pertinent questions, Joseph would be evasive or put him off. Lalan never pressed the matter.

Lalan, 160 B.R. at 858.

Other courts have similarly found that a failure to adequately conduct due diligence could lead to a finding of a lack of good faith. *See, e.g., Cuthill v. Kime* (*In re Evergreen Sec., Ltd*.), 319 B.R. 245, 253 (Bankr. M.D. Fla. 2003) (No good faith defense where broker did not perform even minimal due diligence prior to soliciting "investors" for Ponzi and should have examined: "(i) the financial, performance, and personnel background of the investment manager or the offering company; (ii) the associated risk factors and costs surrounding the investment strategy or product need to be disclosed and evaluated; and (iii) should not rely solely on a sponsor's or issuer's word about an investment product . . .").

Once on inquiry notice, courts vary in the standards they apply as to what type of investigation is required. Some courts have taken a hard line approach finding that any red flags causing inquiry notice prohibits the good faith defense. *Bayou Group* at 848. The *Bayou* court explained:

> . . . any rational investor or financial advisor, on inquiry notice of a warning signal respecting an investment, would be entirely justified in requesting or recommending redemption and could not criticized for doing so. Indeed, it would be quite reasonable for an investor to decide to redeem solely on the basis of the red flag without making any inquiry. But if he does so, the courts have held that he cannot invoke the food faith defense under Section 548(c)."

Id.

The *Bayou* court developed an alternative two prong test in order for a transferee to successfully assert a good faith defense.

(1) The transferee is not on inquiry notice, as evidenced by its lack of knowledge of any "red flags"; or

(2) The transferee can prove by objective evidence that it made its request for redemption for a reason other than its knowledge of "red flags.

Bayou, at 848.

Other courts look at what investigation actually took place and what the defendant learned. In *Bear Stearns Secs Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.*), 397 B.R. 1 (S.D.N.Y. 2007), the court found that the defendants undertook an investigation after it was on notice of certain red flags, and that since the defendants did not find a smoking gun, they were found in good faith.

D. Recent Ponzi Cases Addressing Good Faith

In *Picard v. Katz*, 462 B.R. 447 (S.D.N.Y. 2011), the trustee advanced two theories to demonstrate a lack of good faith on the part of the defendants. First, the trustee argued "that if the defendants willfully blinded themselves to the fact that Madoff Securities was involved in some kind of fraud, this too might, depending on the facts, constitute a lack of good faith." *Id*. at 454. Second, "defendants were on 'inquiry notice' of the fraud but failed to diligently investigate Madoff Securities and that this also constitutes lack of good faith." *Id*.

The court noted that, "The difference between the inquiry notice approach and the willful blindness approach is essentially the difference between an objective standard and a subjective standard." *Id*. at 455. The court concluded:

> A securities investor has no inherent duty to inquire about his stockbroker, and SIPA creates no such duty. See generally In re New Times Sec. Servs., 371 F.3d 68, 87 (2d Cir.2004). If an investor, nonetheless, intentionally chooses to blind himself to the "red flags" that suggest a high probability of fraud, his "willful blindness" to the truth is tantamount to a lack of good faith. See

> United States v. Rodriguez, 983 F.2d 455, 458 (2d Cir. 1993) ("conscious avoidance," another term for willful blindness, means "that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact"). But if, simply confronted with suspicious circumstances, he fails to launch an investigation of his broker's internal practices—and how could he do so anyway?—his lack of due diligence cannot be equated with a lack of good faith, at least so far as section 548(c) is concerned as applied in the context of a SIPA trusteeship.

Id.

In defining good faith, the court stated, "if the defendants willfully blinded themselves to the fact that Madoff Securities was involved in some kind of fraud, this too might, depending on the facts, constitute a lack of good faith." *Id*. at 454.

Picard also argued the objective standard of good faith and inquiry notice. In rejecting the objective standard, the court acknowledged the precedent for the theory in general bankruptcy cases, but held that the objective test should not be applied in a SIPA proceeding because under federal securities laws, proof of scienter is required for liability, and an investor is under no duty to investigate his stockbroker. "If an investor, nonetheless, intentionally chooses to blind himself to the 'red flags' that suggest a high probability of fraud, his 'willful blindness' to the truth is tantamount to a lack of good faith." *Id*. 455.

In a later decision in *Picard v. Katz*, 2012 U.S. Dist. LEXIS 29689 (S.D.N.Y. March 5, 2012), the court partially granted the trustee's motion for summary judgment and denied defendants' motion for summary judgment. Picard sought to avoid Madoff's payments to the defendants of $83,309,162 in net profits in the 2 years before the case was filed. The court found that there was no value given in exchange for the profits, so no defense could be established. The court, therefore, found that the remaining issue for trial is "whether the defendants acted in good faith when they invested in Madoff Securities in the two years prior to bankruptcy or

whether, by contrast, they willfully blinded themselves to Madoff's Ponzi scheme." *Id.* at *8. The court noted, "The defendants' motion for summary judgment is denied, though the Court remains skeptical that the Trustee can ultimately rebut the defendants' showing of good faith, let alone impute bad faith to all the defendants." *Id*. at *7.

In *Picard v. Greiff*, 2012 WL 1505349 (S.D.N.Y. April 30, 2012), Picard filed 80 suits to recover fraudulent transfers from Madoff investors. The defendants filed motions to dismiss under Rule 12(b)(6), in part asserting a good faith value defense under § 548(c). Judge Rakoff noted, "The parties primarily dispute whether the defendants received transfers from Madoff Securities 'for value.'" *Id*. at *6. However, in a footnote to that observation, Judge Rakoff addressed Picard's argument that "if the Court finds that defendants took 'for value,' it should impute Madoff Securities' bad faith to defendants because Madoff Securities acted as their agent." *Id*. at *6, n.9. The court stated:

> However, "when an agent is engaged in a scheme to defraud his principal, either for his own benefit or that of a third person, the presumption that knowledge held by the agent was disclosed to the principal fails because he cannot be presumed to have disclosed that which would expose and defeat his fraudulent purpose." Ctr. v. Hampton Affiliates, 66 N.Y.2d 782, 784, 497 N.Y.S.2d 898, 488 N.E.2d 828 (1985), cited with approval in Kirchner, 15 N.Y.3d at 466, 912 N.Y.S.2d 508, 938 N.E.2d 941. Thus, because the Trustee's allegations describe in detail how Madoff Securities "engaged in a scheme to defraud" these defendants, the Trustee cannot impute Madoff Securities' bad faith to them.

Id.

In *Stoebner v. Ritchie Capital Mgmt.* (*In re Polaroid Corp.*), 472 B.R. 22 (Bankr. D. Minn. 2012), a suit related to the Petters Ponzi case, the trustee sought to avoid the debtors' grant of a security interest to the defendants as an actual fraudulent transfer. The security interest had been granted to secure the debts of related entities in the Ponzi scheme. The court granted the

trustee's motion for summary judgment on the prima facie claim, applying the "Ponzi presumption." The court then addressed the defendants' good faith value defense:

> As to the good-faith element, the inquiry once again goes to a state of mind. This time, it is on the part of the transferee. Direct proof is again relatively rare; so the appellate courts have authorized fact-finding based on the sort of objective evidence that is more likely forthcoming. They permit the ultimate intent to be deemed on findings of the right sort-recognizing the conclusions that any rational participant in such a transaction would reach on learning of such circumstances.

Id. at *60.

The court adopted the objective standard of good faith:

> Even though the focus of the inquiry is 'subjective' in a connotative sense, courts look to what the transferee objectively knew or should have known instead of examining the transferee's actual knowledge from a subjective standpoint. In other words, a transferee does not act in good faith when he has sufficient knowledge to place him on inquiry notice of the debtor's possible insolvency.

Id. (quotation marks and citations omitted).

The court then found that the debtor had not received any value for the transfer because the transfer was to secure the debts of other entities. The court also rejected the defendants' claim of good faith:

> But, by the late summer of 2008, the Ritchie entities' personnel and their attorneys expressly recognized that the Petters enterprise structure and its component entities might well be insolvent themselves, burdened by heavy debt to their own creditors. . . . [T]he Ritchie entities' receipt of a transfer of valuable property rights from the Polaroid Corporation, in the form of liens, would shove that grantor's creditors aside from any recovery of the corresponding value. The Trustee has produced unrebutted evidence of that notice; and the inference of the awareness of the consequence follows, without evidentiary rebuttal by the Ritchie Defendants. This is sufficient to bar a finding for them on their conclusory assertion of good faith . . .

Id. at *68.

In *Silverman v. Meister Seelig & Fein, LLP* (*In re Agape World, Inc.*), 467 B.R. 556 (Bankr. E.D.N.Y. 2012), the trustee sued the Ponzi perpetrator's law firm for recovery of legal fees as a fraudulent transfer. The defendants filed a motion to dismiss, in part asserting a good faith value defense under § 548(c). Initially, the court held, "it is only sufficient to dismiss these claims at this stage if it appears from the face of the Complaint that the Defendant took the funds in good faith and for fair consideration." *Id*. at 570. The court denied the motion, concluding, "The Trustee sufficiently alleges the Defendant had knowledge of Agape's wrongdoing . . ." *Id*.

In *Bayou Superfund, LLC v. D. Canale Beverages, Inc.* (*In re Bayou Group, LLC*), 2012 WL 386275 (S.D.N.Y. Feb. 6, 2012), the debtors brought fraudulent transfer claims against several defendants. Following a jury verdict in the plaintiff's favor, some of the defendants moved for judgment as a matter of law, asserting the good faith value defense under § 548(c). The court noted that in a prior decision reversing the bankruptcy court's grant of summary judgment on this issue, *In re Bayou Group, LLC*, 439 B.R. 284 (S.D.N.Y.2010), it had held that the proper test is "whether the alleged 'red flag' information would have put a reasonably prudent institutional hedge fund investor on inquiry notice that Bayou was insolvent or that it had a fraudulent purpose in making the redemption payments to [Defendants]." *Id*. at 313. The court then continued, "Once a transferee is placed on inquiry notice, it must conduct a diligent investigation of the facts that put it on inquiry notice, or demonstrate that a diligent inquiry would not have uncovered the transferor's insolvency or fraudulent purpose in making the payment." *Bayou Super Fund*, 2012 WL 386275, at *1. Because there were issues of fact on this question, a trial was ordered and the verdict went against the defendants.

In discussing their motion for judgment as a matter of law, the court observed, "Defendants do not dispute that they were aware of sufficient 'red flag' information to put a reasonably prudent hedge fund investor on notice that the Bayou hedge funds were insolvent or that the redemption payments might be made with a fraudulent purpose. . . . Instead, Defendants argue that "the jury was not presented any evidence challenging . . . Defendants' evidence that they could not have uncovered the fraudulent business operation at the Bayou Hedge Funds." *Id*.

The court denied the motion, concluding, "Here, there is ample evidence supporting the jury's conclusion that a diligent investigation would have led to discovery of the fraud." *Id*. at *7. The court first cited that the relationship between Daniel Marino, one of the Ponzi perpetrators, and Richmond-Fairfield, Bayou's auditor; Marino was its registered agent in the public record. The court also noted that one Bayou investor had discovered this on the internet with a few hours of investigation. This relationship suggested that Bayou's audits were not independent. An investigation of state records would also have disclosed that there was no Richmond-Fairfield accounting firm and that therefore it was phony. This suggested that the accounting firm's statements were also phony, and that "the Bayou Funds might be operating as a fraud, and that redemption payments made by the Funds might be designed to avoid discovery of the fraud." *Id*. at *8.

In *O'Cheskey v. Housing for Texans Charitable Trust* (*In re American Housing Foundation*), 2012 WL 4622310, (Bankr. N.D. Tex. Sept. 30, 2012), the trustee's fraudulent transfer claims against defendant Scott Rice arose out of a Ponzi scheme perpetrated by Steve Sterquell. The court sustained Rice's good faith defense, finding:

> Steve Sterquell was a trusted family friend and adviser, a relationship that originated with Scott Rice's parents. Scott Rice was dependent on Sterquell and was obviously deferential to him. Though Scott Rice served as a director of AHF and ostensibly had

> the opportunity to inquire of AHF's activities, it is also apparent that Sterquell totally controlled and manipulated AHF and its activities. It is an understatement to describe the AHF activities and Steve Sterquell's use of AHF as complicated. AHF was a non-profit entity at the top of a pyramid that included over sixty other for-profit entities, all of which were being operated and used by Steve Sterquell. Gaining any real substantive understanding of what was truly happening for someone of Scott Rice's experience level was unlikely. In addition, Sterquell was a co-trustee of the Rice Trust. As between Scott Rice and Steve Sterquell in their respective capacities as co-trustees and co-directors, Steve Sterquell was clearly the dominant and controlling person.

Id. at *16. *See also Gold v. First Tennessee Bank* (*In re Taneja*), 2012 WL 3073175 (Bankr. E.D. Va. July 30, 2012) (sustaining the defendant's good faith defense).

IV. Conclusion

The bottom line is that investors, sales people, professionals and even charitable organizations are often subject to claw back claims brought by receivers. The outcomes in these cases may hinge on the types of claims brought, the good faith of the players, and the case law in the jurisdiction.