

PICK YOUR GOLFING AND CONTRACT PARTNERS CAREFULLY

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What can be better than the intersection of golf and law? In the aftermath of the recent Masters Tournament, we thought you would be interested in a decision last month by the Fifth Circuit Court of Appeals that should be a cautionary tale about vetting your tenants or other contract partners. Presenting the cast of characters, the storyline and the moral of the story:

Alan Stanford and the Stanford International Bank Ltd: The perpetrators of a multi-million dollar (did I say “million,” Dr. Evil? I meant “billion”) Ponzi scheme through more than 130 affiliated entities in which investors were promised exceptionally high interest rates on certificates of deposit. The problem is that the “returns” were funded by investments from other investors’ principal. Before collapsing, Stanford had raised over \$7 billion selling these fraudulent CD’s.

Ralph Janvey: The court appointed receiver who has been attempting to recover proceeds from the ill-gotten gains of those who received funds or property from the Stanford entities. He has filed scores of lawsuits in an attempt to recover money on behalf of those defrauded by Mr. Stanford.

The Golf Channel: As the name indicates, a cable/satellite channel dedicated to broadcasting everything having to do with golf including tournaments, interviews, lessons, opinions, etc.

Fifth Circuit Court of Appeals: The appeals court located in New Orleans which handles appeals from bankruptcy and federal district courts located in Texas, Louisiana and Mississippi. While it deals primarily with federal law, the court can and does interpret state law when appropriate.

→ **The Law:** Just about all jurisdictions, including Texas and the federal government, have a set of laws that allow courts to undo transactions that were intended to hinder, delay, or defraud a creditor of a transferor of property. The Texas Uniform Fraudulent Transfer Act and similar laws were enacted to protect creditors against the depletion of a transferor-debtor’s estate. Simply put, if you are a creditor of a person or company who has transferred property to a third party, with the intent to keep you from reaching that property, or for such small consideration that it would be unfair for the recipient to keep that property, you can seek relief from a court to unwind that transaction and force the recipient to pay the money to the creditors or suffer a judgment for that transfer. The funds would go to the aggrieved creditors, either directly or through a trustee or receiver of the transferor’s estate. Please note that this is an oversimplification of a statute that is quite complicated.

A recipient of a transfer may have a good defense if it can show that it took the transfer in “good faith” and it gave the transferor “reasonably equivalent value” for it.

The Plot: In an attempt to increase awareness of his “brand” among sports audiences, Mr. Stanford and The Golf Channel entered into a comprehensive agreement in which The Golf Channel provided all sorts of marketing services including air-time, live coverage of a tournament sponsored by Stanford (believe it or not, the Stanford St. Jude’s Championship), and other promotions of Stanford’s investment opportunities for which The Golf Channel received \$5.9 million. After he was appointed receiver, Mr. Janvey filed suit against the Golf Channel for the \$5.9 million. The Golf Channel argued that it accepted the money in good faith and it provided approximately \$5.9 million in services to Stanford. Sound reasonable? Maybe. But let’s see how the court handled it.

→ The Conclusion: In its March 11, 2015 decision, the Fifth Circuit first held that proof of a Ponzi scheme establishes that the transfers associated with it were fraudulent. The court also determined that The Golf Channel took the payments in good faith because it had no reason to know of the scheme. However, as to whether reasonably equivalent was exchanged, the court ruled that it was required to look to the benefit the transfer bestowed upon the creditors of Stanford, not the benefit that Stanford may have received from the services. Under these set of facts, the advertising services that encouraged others to invest in a Ponzi scheme did not benefit the creditors of Stanford, but simply exacerbated the fraud. Although the “market value” of the services may have been \$5.9 million, the court concluded that it had no value to Stanford’s creditors and ordered that The Golf Channel pay the \$5.9 million into the Stanford estate for distribution to Stanford’s creditors.

The Moral: The court conceded that its holding may have been different if Stanford had been involved in a legitimate business. While it may be too early to fully assess the impact of this decision, it appears to impose an unrealistic expectation for trade creditors (including landlords) to investigate the affairs of their customers because even innocent parties can be subject to fraudulent transfer claims if they do business with what turns out to be a Ponzi scheme. If you are dealing with a sales or investment company as a tenant, it might not be a bad idea to do a little extra research and make sure the company does not simply take new investor money to pay off prior investors. It may be difficult to ferret out such shenanigans, but the Fifth Circuit seems to have put the interests of creditors/investors of a failed Ponzi scheme over the claims of innocent merchants, who are often victims also