

DEBTOR/CREDITOR

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Hidden Benefit of Ponzi Scheme

As a general rule, when an insolvent corporation redeems its own stock, that redemption payment may later be recovered by the corporation's bankruptcy trustee as a fraudulent transfer. This is because the corporation does not receive anything of value in exchange for the payment; it is merely purchasing itself.

However, a federal appeals court recently decided that this general rule did not apply where the insolvent corporation was itself a Ponzi scheme. In such a situation, the unwitting shareholder had a fraud claim against the corporation for the amount of the "investment". The redemption payment satisfied that fraud claim, thereby paying a debt of the corporation. This satisfaction of debt was a fair exchange of value for the payment. Any amounts paid in excess of the shareholder's initial investment could be recovered by the trustee as a fraudulent transfer.

Perkins v. Haines, 661 F.3d 623 (5th Cir. 2011).

Borrowing from Peter to Pay Paul

Richard was the sole shareholder of Action Electric. He personally guaranteed the company's obligations to its bank. Action Electric had overdraft protection on its checking account. The account was always overdrawn. The company used the overdraft protection as a line of credit to pay all of its bills. The company would deposit receipts into the account, which reduced the amount of the overdraft. The bills paid in this manner included regular tax payments to the United States and to Wisconsin.

After the business failed, Richard filed a personal bankruptcy case. The bank sought to prevent the discharge of Richard's guaranty obligations for the amount of the tax payments made from the account under a portion of the bankruptcy statute that prohibits discharge of debts "incurred to pay a tax". Richard argued that (1) he had deposited into

the account each month more money than was required to pay the taxes, (2) those deposits should be credited to the tax payment and (3) he should not be viewed as having borrowed from the bank to make the payments.

A Wisconsin bankruptcy judge rejected Richard's argument, concluding that any repayment of the overdraft debt did not alter the fact that the money to pay the taxes was borrowed.

Bank of Kaukauna v. Vandynhoven (In re Vandynhoven), 460 B.R. 214 (Bankr. E.D. Wis. 2011).

No Triangular Setoff

The federal bankruptcy statute preserves the ability of a creditor to set off amounts the creditor owes to the debtor against obligations of the debtor to the creditor, provided that the setoff is permissible under nonbankruptcy law. A New York bankruptcy judge recently limited the scope of the setoff right.

A debtor and a creditor were parties to a contract which permitted the creditor to set off amounts owed to the debtor against amounts owed by the debtor to an affiliate of the creditor. The bankruptcy court acknowledged that this triangular setoff was valid under state law, but held that the bankruptcy statute permitted the set off only of mutual debts between the same two entities.

In re Lehman Brothers, Inc., 458 B.R. 134 (Bankr. S.D.N.Y. 2011).

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This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.

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