IN THE CIRCUIT COURT OF THE SEVENTEENTH JUDICIAL CIRCUIT, IN AND FOR BROWARD COUNTY, FLORIDA

Case No. 12-034121 (07)

P &S ASSOCIATES, GENERAL PARTNERSHIP, a Florida limited partnership, *et al.*,

Plaintiffs,

v.

JANET A. HOOKER CHARITABLE TRUST, a charitable trust, *et al.*,

Defendants.

_____/

PLAINTIFFS' RESPONSE AND MEMORANDA IN OPPOSITION TO DEFENDANT JAMES AND VALERIE JUDD'S MOTION FOR SUMMARY JUDGMENT

Plaintiffs, P & S Associates, General Partnership ("P&S"), and S & P Associates, General Partnership ("S&P"), *et al.*, (collectively and individually referred to as, the "Partnerships" or "Plaintiffs"), by and through their undersigned attorneys, file this Response and Memoranda in Opposition to Defendants James and Valerie Judd's ("Defendants") Motion for Summary Judgment (the "Motion").

I. STATEMENT OF FACTS

This action names as defendants those particular partners of the Partnerships who received, on a net basis, more money than they invested; i.e., 'Net Winners.'

On or about April 25, 2014, Defendants filed the Motion seeking summary judgment. Based on the Motion, the following facts preclude entry of Summary Judgment between the parties:

BERGER SINGERMAN
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t: 954-525-9900 | *f:* 954-523-2872 | WWW.BERGERSINGERMAN.COM

- The Conservator could not have reasonably discovered the transfer of the improper distributions to Defendant prior to his appointment.
- A demand for the return of the amounts improperly received by Defendant could not have been made earlier than the appointment of Margaret Smith as Managing General Partner.
- The discovery of the Madoff fraud could not have reasonably led to the discovery of the claims against the Defendant by the Conservator.
- James and/or Valerie Judd signed the Partnership Agreements. *See* **Exhibit 1.**

By the Motion, Defendants assert that despite the improper circumstances under which they received distributions they are entitled to summary judgment because James Judd allegedly did not sign the agreement.

LEGAL ARGUMENT

For purposes of brevity, and because Defendants incorporate by reference of the arguments of the other Defendants, Plaintiffs reincorporate by reference their responses to those arguments of the other Defendants and the exhibits attached to those responses as evidence.

Additionally, Defendants have argued that there is no evidence that they knew of impropriety. However, whether Defendants acted improperly is immaterial to Plaintiffs' fraudulent transfer claims. In fact, Plaintiffs do not have to demonstrate that Defendants had no knowledge of wrong doing, so long as they are only seeking to recover "the fictitious profits paid to [Defendants] in excess of their initial investments." *See Wagner v. Lankford*, Case No 10-10759, Adv. No. 12-1139 (Bankr. D. N.M. May 27, 2014) (denying summary judgment despite defendants lack of knowledge.); *In re McCarn's Allstate Fin., Inc.*, 326 B.R. 843, 852 (Bankr. M.D. Fla. 2005) ("The Trustee does not dispute the Defendants' assertions that they were

completely innocent of any wrongdoing and that they had no knowledge of the fraudulent nature of the Debtor's Ponzi scheme. Unfortunately for these Defendants, "'[n]either innocence in action nor unfairness in result is a defense.'").[1] Further, Plaintiffs reincorporate by reference their Supplemental Brief in relation to the Motions for Summary Judgment.

Additionally, Defendants have alleged that Plaintiffs have failed to set forth any allegations which indicate that they received a copy of the Partnership Agreements, or refute the affidavit of Valerie Judd, which provides in relevant part that James Judd did not receive or sign a partnership agreement. Notwithstanding the fact Valerie Judd cannot prove that there is no material issue of fact as to whether James Judd signed the Partnership Agreements by virtue of her self-serving affidavit, the signature page attached to her affidavit appears to have two signatures, and lists both James and Valerie Judd as partners. The fact that both James and Valerie Judd were partners in the partnerships is further demonstrated by the fact that both of their social security numbers were listed in the Partnership Agreements. Moreover, after providing a capital contribution to the Partnerships, both James and Valerie Judd received a letter from the Partnerships which purported to enclose the Partnership Agreements to them. The letter also refutes the statement that neither James nor Valerie Judd received a copy of the Partnerships' Partnership Agreements. Accordingly, Plaintiffs additionally submit that summary judgment should be denied because there is an issue of fact as to whether Defendant signed the Partnership Agreements.

The remainder of Defendants' arguments consists of a series of quotations of the Partnership Agreements, or questions which further demonstrate that entry of summary judgment is improper.

[1] True and correct copies of the aforementioned cases have been attached hereto as Exhibit 2.

WHEREFORE the Plaintiffs request that this Court enter an order denying Defendants' Motion for Summary Judgment, together with such other and further relief as the Court may deem just and appropriate under the circumstances.

Dated: June 2, 2014

By: s/ Leonard K. Samuels

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been served via Electronic Mail on this 2nd day of June, 2014 upon the following:

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EXHIBIT 1

Sullivan & Powell
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Michael D. Sullivan
Gregory O. Powell, E.A.

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Telephone 954-492-0088

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July 24, 2000

James & Valerie Judd
2421 Barcelona Dr.
Ft. Lauderdale, FL 33301

Dear James & Valerie,

We are in receipt of your check in the amount of $100,000.00 as a capital contribution to S & P Associates, General Partnership, an investment club. These funds are being forwarded to the investment broker. You also have the privilege of adding to your account at anytime you desire.

We acknowledge our responsibility as managing partners to keep you informed with the return on our collective investments and your porportionate share of the profits and losses.

It is our intent that all partners receive a copy of the Partnership Agreement for review and as part of your financial records. If you have not received this document, please let us know and we will forward a copy to you.

If we are in need of additional information, it will be indicated below. We would appreciate your timely response so our records will be accurate and we are in compliance with reporting and filing requirements.

Sincerely,

Michael Sullivan and Greg Powell, Managing Partners
S & P Associates, General Partnership

FILE COPY

EXHIBIT 2

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

In re: VAUGHAN COMPANY, REALTORS, Case No. 10-10759

Debtor.

JUDITH A. WAGNER, Chapter 11 Trustee
Of the bankruptcy estate of the Vaughan Company,
Realtors,

Plaintiff,

v. Adv. No. 12-1139

DAVID LANKFORD and
LEE ANN LANKFORD,

Defendants.

MEMORANDUM OPINION

THIS MATTER is before the Court on the Motions for Summary Judgment (the "Motions" or "Motions for Summary Judgment") filed by the Chapter 11 Trustee. *See* Docket Nos. 52 and 56. The Trustee seeks to recover as fraudulent transfers all fictitious profits paid by the Debtor to Defendants David and Lee Ann Lankford pursuant to a Ponzi scheme. The Lankfords contend, among other things, that the litigation is fundamentally unfair and that any recoverable amounts should be reduced by the taxes and fees they paid before using the funds. After considering the Motions, the Lankfords' responses and supplemental responses, and the supporting papers, and being otherwise sufficiently informed, the Court finds the Motions should be granted, as described below.

SUMMARY JUDGMENT STANDARDS

Summary judgment will be granted when the movant demonstrates that there is no genuine dispute as to a material fact and that the movant is entitled to judgment as a matter of law. *See* Fed.R.Civ.P. 56(a), made applicable to adversary proceedings by Fed.R.Bankr.P. 7056. "[A] party seeking summary judgment always bears the initial responsibility of informing the ... court of the basis for its motion, and ... [must] demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). In considering a motion for summary judgment, the Court must "examine the factual record and reasonable inferences therefrom in the light most favorable to the party opposing summary judgment." *Wolf v. Prudential Ins. Co. of America*, 50 F.3d 793, 796 (10th Cir. 1995) (quoting *Applied Genetics Int'l, Inc. v. First Affiliated Sec., Inc.*, 912 F2d 1238, 1241 (10th Cir. 1990)). "[A] party opposing a properly supported motion for summary judgment may not rest on mere allegations or denials of his pleading, but must set forth specific facts showing that there is a genuine issue for trial" through affidavits or other supporting evidence. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256, 106 S.Ct. 2505, 91 L.Ed .2d 202 (1986).

PROCEDURAL BACKGROUND

The Trustee commenced the above-captioned adversary proceeding in February, 2012. She sought to avoid certain transfers from the Vaughan Company Realtors ("VCR") to the Lankfords, jointly, and to David Lankford, individually, pursuant to 11 U.S.C. §§ 544 and 548 and New Mexico's version of the Uniform Fraudulent Transfer Act ("UFTA"), N.M.S.A. 1978 §§ 56-10-18 and (19). Based on her review of spreadsheets maintained by VCR reflecting Form 1099 interest disclosures, the Trustee originally asserted that the Lankfords jointly received at least $144,976.56 in transfers from VCR over the life of their investments and that David

Lankford, individually, received $199,160.47 during such time. The Lankfords disputed the accuracy of those figures. In August 2013, the Court directed the Trustee to explain her calculations to the Lankfords. After obtaining additional financial documents, the Trustee determined that the complaint overstated the amounts paid to the Lankfords, jointly, by $4,037.24 and to David Lankford, individually by approximately 40-60 cents. The Trustee adjusted the amounts sought accordingly.

As a result of the Trustee's accounting errors, the relationship between the litigants deteriorated. The Lankfords requested leave to file a counterclaim against the Trustee and her counsel for extortion, incompetence, and fraud. The Court denied the request because the Lankfords did not make a prima facie showing that the Trustee or her counsel engaged in such conduct. *See* Memorandum Opinion and Order Denying Motion to File Counterclaim (Docket No. 81).

In September and October of 2013, the Trustee filed the Motions for Summary Judgment. Although the Lankfords, who are unrepresented, made a good faith effort to respond to the Motions, their original responses contained several procedural defects. In the interest of reaching the merits of the parties' arguments, the Lankfords were permitted to supplement their responses pursuant to Fed.R.Civ.P. 56(e)(1). *See* Order Striking Sur-Reply, Allowing Defendants to Supplement Response, and Vacating Trial Setting (Docket No. 86) (the "Order Allowing Supplementation"). The Court gave the Lankfords instructions regarding how to dispute the Trustee's proffered facts as well as how to set forth additional facts in support of their responses. The Court also warned both parties that it would only consider facts set forth in a separate statement of material facts and supported by admissible evidence. The Lankfords then

filed supplemental responses, to which the Trustee was given an additional opportunity to respond.

By her Motions for Summary Judgment, the Trustee appears to have originally sought to recover the entire amounts paid to the Lankfords, jointly, and David Lankford, individually, within four years before the bankruptcy case was commenced. The Court understands that in her supplemental replies, the Trustee limited the requested relief to recovery of the fictitious profits paid to the Lankfords in excess of their initial investments in the Ponzi scheme (*i.e.* "Net Winnings").[1] *See* Docket Nos. 93-94 (together the "Supplemental Replies"). For purposes of this ruling, the Court therefore limited its focus to whether, and to what extent, the Lankfords, jointly, and David Lankford, individually, received avoidable Net Winnings.

UNDISPUTED FACTS RELATING TO ALL PARTIES

A. VCR filed a voluntary petition under Chapter 11 of the Bankruptcy Code on February 22, 2010 (the "Petition Date"). *See* Docket No. 1 in Case No. 10-10759.

B. The Trustee commenced the above-captioned adversary proceeding on February 21, 2012. *See* Trustee's Complaint, Docket No. 1 in Adv. No. 12-1139.

[1] Only the Supplemental Reply relating to David Lankford expressly states that if the Trustee obtains a judgment in the amount of the Net Winnings, she will not attempt to recover greater amounts. However, that intention is implicit in the Supplemental Reply relating to the Lankfords' joint investment (Docket No. 91). In that document, the Trustee states that she only seeks to recover Net Winnings on summary judgment, not all of the amounts transferred during the four year look-back period. She also states that the Lankfords' contentions regarding the amount of transfers made to them during the four year look-back period are moot. Based on these representations, the Court infers that the Trustee only seeks to recover Net Winnings from the Lankfords in connection with their joint investments.

UNDISPUTED FACTS RELATING TO THE LANKFORDS' JOINT INVESTMENTS[2]

1. David and Lee Ann Lankford jointly invested a total of $95,000 in VCR's promissory note program (*i.e.* the Ponzi scheme). *See* Trustee's Motion for Partial Summary Judgment as to the Timing and Amount of the Transfers Against David Lankford and Lee Ann Lankford on Account of Joint Investment (the "Motion Relating to the Joint Investment") (Docket No. 56), ¶ 2; Supplemental Response to the Motion Relating to the Joint Investment (the "Joint Supplemental Response") (Docket No. 91), p. 5 of 21.

2. From 2004 through the Petition Date, the Lankfords received $140,939.32 from VCR on account of their joint investments in the Ponzi scheme. *See* Motion Relating to the Joint Investment, ¶ 3; Joint Supplemental Response, p. 5 of 21.

3. VCR paid $45,939.32 more to the Lankfords than they originally invested.[3] *See* Motion Relating to the Joint Investment, ¶ 5; Undisputed facts No. 1 and 2.

4. VCR transferred the Net Winnings ($45,939.32) to the Lankfords within four years before the Petition Date.[4] *See* Motion Relating to the Joint Investment, ¶ 4; Affidavit of Judith Wagner, Chapter 11 Trustee, attached as Exhibit C to the Motion Relating to the Joint

[2] In finding the undisputed facts, the Court considered the Trustee's Motion for Summary Judgment as to the Timing and Amount of the Transfers to David Lankford and Lee Ann Lankford (Docket No. 56), the Lankfords' original objection to that motion (Docket No. 67), the Trustee's original reply (Docket No. 70), the Lankfords' supplemental response (Docket No. 91), the Trustee's supplemental reply (Docket No. 94), and all supporting papers accompanying those documents, to the extent such papers could be presented in an admissible form at trial.

[3] In their Joint Supplemental Response, the Lankfords contend that they did not benefit from much of the Net Winnings. However, they did not specifically dispute the amount stated by the Trustee or offer admissible evidence that they received a different amount before payment of taxes and IRA fees are taken into account.

[4] The parties dispute the exact amount transferred within four years before the Petition Date. The exhibits attached to the Motion Relating to the Joint Investment, which include copies of the checks issued by VCR to the Lankfords, establish that the Lankfords received over $100,000 during the four year look-back period. The Lankfords did not offer admissible evidence to dispute this fact. Thus, calculated in accordance with the "netting ruling," as addressed below, the Court is able to conclude that principal was repaid before any fictitious profits and that at least $45,939.32 in fictitious profits was transferred within four years before February 22, 2010.

Investment (Docket No. 56-3), ¶ 10; Checks reflecting payments from VCR to the Lankfords, attached to the Trustee's affidavit (Docket No. 56-4).

UNDISPUTED FACTS RELATING TO DAVID LANKFORD'S INVESTMENTS[5]

5. David Lankford individually invested a total of $177,695 in VCR's promissory note program. *See* Trustee's Motion for Partial Summary Judgment as to the Timing and Amount of the Transfers Against David Lankford (the "Motion Relating to David Lankford") (Docket No. 52), ¶ 2; Supplemental Response to the Motion Relating to David Lankford ("David Lankford's Supplemental Response") (Docket No. 92), p. 2 of 46.

6. From 2003 through the Petition Date, David Lankford received $199,160.07 from VCR on account of his individual investments in the Ponzi scheme. *See* Motion Relating to David Lankford, ¶ 3; David Lankford's Supplemental Response, p. 2 of 46.

7. VCR paid $21,465.07 more to David Lankford than he originally invested.[6] *See* Motion Relating to David Lankford, ¶ 6; Undisputed facts No. 1 and 2.

8. VCR transferred the Net Winnings ($21,465.07) to David Lankford within four years before the Petition Date.[7] *See* Motion Relating to David Lankford, ¶ 5; David Lankford's Supplemental Response, p. 3 of 46; Zia Trust Account Ledger titled "History for 1/1/1997 to 12/31/2011 for … David L. Lankford R/O IRA" and Summary of the Zia Ledger prepared by

[5] In finding the undisputed facts, the Court considered the Trustee's Motion for Summary Judgment as to the Timing and Amount of the Transfers to David Lankford Individually (Docket No. 52), David Lankford's original objection to that motion (Docket No. 60), the Trustee's original reply (Docket No. 68), the Lankfords' supplemental response (Docket No. 92), the Trustee's supplemental reply (Docket No. 93), and all supporting papers accompanying those documents, to the extent such papers could be presented in an admissible form at trial.

[6] In his Supplemental Response, David Lankford contends that he did not benefit from much of the Net Winnings. However, he did not dispute the amount stated by the Trustee or offer admissible evidence that they received a different amount before payment of taxes and IRA fees are taken into account.

[7] Mr. Lankford disputes the exact amount transferred within the four year look-back period. He admits, however, that he received $106,409.78 within two years before the Petition Date. Thus, calculated in accordance with the "netting ruling," as addressed below, the Court is able to conclude that principal was repaid before any fictitious profits and that at least $21,465.07 in fictitious profits was transferred within four years before February 22, 2010.

counsel for the Trustee, filed of record in connection with the Motion Relating to David Lankford as Corrected Exhibit B (Docket No. 65).

DISCUSSION

The Trustee seeks summary judgment on her constructive fraud claims in the amount of the Net Winnings paid to the Lankfords, jointly, and David Lankford, individually, during the four year look-back period. Claims for constructive fraud generally require a showing that the debtor: (1) transferred property within two or four years before the bankruptcy filing; (2) received less than reasonably equivalent value for the transfer; and (3) was insolvent (or some equivalent) at the time of the transfer. *See generally* 11 U.S.C. § 548(a)(1)(B); N.M.S.A. 1978 § 56-10-18(A)(1)(2).

By a memorandum opinion entered October 23, 2013, the Court found that, to the extent a transfer was made to the Lankfords within four years before the Petition Date: (1) each transfer constituted an interest of VCR in property; (2) VCR received less than reasonably equivalent value in exchange for the transfer of any returns in excess of the Lankfords' original investment (*i.e.* Net Winnings); and (3) on the date of each transfer, VCR was insolvent and/or believed (or reasonably should have believed) it would incur debts beyond its ability to repay.[8] *See Wagner v. Oliva, et al*, 500 B.R. 778 (Bankr.D.N.M. 2013) or Docket No. 74 in Misc. Adv. No. 12-0006. The Court also determined that VCR operated as a Ponzi scheme from at least 2005 through the Petition Date. *Id.* The only remaining issue with respect to the Trustee's constructive fraud claims is whether, and to what extent, the transfers actually occurred.

[8] Because this adversary proceeding is one of over fifty such cases filed by the Trustee to recover returns and profits paid pursuant to VCR's Ponzi scheme, the Court consolidated various common issues of law and fact. The memorandum opinion entered October 23, 2013 reflects the Court's consolidated rulings as set forth above.

All parties agree on the total amounts the Lankfords, jointly, and David Lankford, individually, invested in the Ponzi scheme. They also agree on the amounts each Defendant received from VCR over the life of the investments. The main point in contention, at least for purposes of this ruling, is how much "cash in hand" the Defendants actually received in excess of their initial investment.

Normally, the Court would calculate such amount by applying the "netting rule." Under that rule, "[a]mounts transferred by the Ponzi scheme perpetrator to the investor are netted against the [total] … amounts invested by that individual." *Donell v. Kowell*, 533 F.3d 762, 771 (9th Cir. 2008). As one court explained:

> If a given defendant received less than his undertaking, the amounts received should be considered return of principal, regardless of how the parties' may have designated them. On the other hand, to the extent all transfers to a defendant exceeded his undertaking, the amounts should be considered so-called earnings [net-winnings], regardless of the parties' designation.

In re Independent Clearing House Co., 77 B.R. 842, 851 n. 14 (D.Utah 1987). *See also Securities Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec, LLC (In re Madoff Sec.),* 476 B.R. 715, 729 (S.D.N.Y.2012) (adopting the "netting rule"); *cf In re Hedged–Inv. Assocs., Inc.),* 84 F.3d 1286, 1289 (10th Cir.1996) (suggesting that the liability of an investor depends on whether they received payments from the Ponzi-perpetrator in excess of their original investment).

Here, the Lankfords argue that simply netting the total amount paid against the total amount invested does accurately capture the amount of Net Winnings they received. First, they appear to contend that they should be entitled to offset from the judgment any taxes and IRA fees they paid on the transfers from VCR. The Tenth Circuit, following established precedent in other circuits, has held that investors "are not entitled to offset taxes paid on their gains from [a] … Ponzi scheme." *Wing v. Dockstader*, 2012 WL 2020666, *4 (10th Cir.2012). *See also Donell*

v. Kowell, 533 F.3d 762, 779 (9th Cir. 2008) (declining to "permit good faith investors to claim offsets for taxes or other expenses paid in connection with receipt and management of income from a Ponzi scheme"). As the Tenth Circuit explained:

> Allowing offsets would frustrate the purposes of the [Uniform Fraudulent Transfer Act] because there is no principle by which they could be limited, it would introduce difficult problems of proof and tracing into each case, and any amount offset would necessarily come at the expense of other investors.

Dockstader, 2012 WL 2020666, *4. The Lankfords are therefore not entitled to offset taxes or IRA fees paid on their gains from VCR, at least in the context of the fraudulent transfer litigation.

Next, the Lankfords contend they invested in good faith pursuant to 11 U.S.C. § 548(c) and N.M.S.A. 1978 56-10-22(A).[9] They point out, for example, that they researched VCR's promissory note program before investing and had no reason to doubt the integrity of Douglas Vaughan, VCR's principal. The Court is sympathetic to the fact that the Lankfords, like so many other defendants, had no actual knowledge of the Ponzi scheme until Douglas Vaughan's crimes came to light. However, the "good faith defense ... [only] permits an innocent investor to retain funds up to the amount of the initial outlay." *Wagner v. Eberhard*, 2014 WL 271632, *5 (Bankr.D.N.M. 2014) (quoting *Donell v. Kowell*, 533 F.3d 762, 771 (9th Cir.2008)).[10] The defense does not prevent a trustee from recovering fictitious profits paid pursuant to a Ponzi

[9] Section 548(c) provides, in relevant part: "a transferee ... that takes for value and in good faith has a lien on or may retain any interest transferred ... to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation." 11 U.S.C. § 548(c). The UFTA provides: "[a] transfer or obligation is not voidable ... against a person who took in good faith and for a reasonably equivalent value." N.M.S.A. 56-10-22(A).

[10] *See also Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011) (holding that the good faith defense under Section 548(c) can only protect Ponzi investors to the extent of their original investment); *Securities Investor Protection Corp. v. Bernard L. Madoff Inv. Securities LLC*, 499 B.R. 416, 422-426 (S.D.N.Y. 2013) (concluding that for purposes of Section 548(c), investors only give "value" to the extent of their original investment); *In re Maui Indus. Loan & Finance Co., Inc.*, 2013 WL 2897792, *6 (D.Hawaii 2013) (noting that the "good faith defense … permits an innocent winning investor to retain funds up to the amount of the initial outlay"); *In re LLS America, LLC*, 2013 WL 3305393, *14 (Bankr.E.D.Wash. 2013) (same).

scheme. *Id*. By her Motions, the Trustee only seeks to recover Net Winnings. The Court therefore cannot consider whether the Lankfords acted in good faith, how much they actually knew, or the circumstances surrounding their investments for purposes of this ruling.

The Lankfords also attempt to defeat summary judgment by complaining about various arithmetic errors made by the Trustee. In their statement of material facts[11] and in the discussion section of their briefs, the Lankfords argue that the Trustee miscalculated the amounts they received during both the two and four year look-back periods. They also contend that the Trustee overstated the amount VCR paid to the Lankfords, jointly, by $4,037.24 after relying on inaccurate spreadsheets reflecting 1099 interest disclosures. Assuming such facts are true, they do not change the result of this ruling. The Trustee is not seeking a judgment for the entire amount VCR transferred to the Lankfords during either the two or four years preceding the Petition Date. The parties' disagreement over those amounts is therefore irrelevant. With respect to the Lankfords' assertions that the Trustee initially overstated the amounts paid to them by $4,037.24, the Trustee admits as much and has adjusted her calculations accordingly. The Motions for Summary Judgment reflect the updated calculations, and the Court did not rely on the overstated amount in connection with this ruling. Instead, it relied on numbers to which all parties agree (*i.e.* the amounts invested by the Defendants and the amounts transferred by VCR) to independently calculate the Net Winnings. Thus, to the extent the Trustee's calculations were initially incorrect, such error has not tainted this ruling.

Finally, the Lankfords point to various ways in which the Trustee has allegedly abused her position. They contend, for example, that the Trustee withheld evidence relating to the 1099 spreadsheets. The 1099 spreadsheets, which formed the basis for the Trustee's initial

[11] The Court considered the arguments set forth in the Lankfords' separate statement of material facts, but it did not deem such facts established. For the most part, the facts were not supported by admissible evidence. Even if the Court considered them, however, they would not have changed the result here.

calculations, are not pertinent to the Court's ruling here. As explained above, the Court relied on the Lankfords' own admissions to calculate the Net Winnings. In addition, there has been no indication that the Trustee or her counsel acted with any nefarious or dishonest motives during the course of this case. The Lankfords also appear to contend that the Trustee violated the applicable statute of limitations and that she intentionally submitted shoddy evidence to the Court just before the limitations period expired. This argument is not well taken. The UFTA, in conjunction with 11 U.S.C. § 544(b), allows a trustee to void fraudulent transfers that occurred within four years before commencement of the bankruptcy case. *See* N.M.S.A.1978 § 56-10-23. A trustee must generally commence the fraudulent transfer litigation within the later of two years after the Petition Date or one year after he or she is appointed. *See* 11 U.S.C. § 546(a). Here, the Trustee is only seeking to recover Net Winnings that were paid during the four year look-back period. Further, she commenced the case within two years of the Petition Date using the available evidence at the time. The Trustee's claims are therefore not time-barred.

The Lankfords, like most innocent investors who unwittingly participated in VCR's Ponzi scheme, are clearly frustrated and upset by the fraudulent transfer litigation. While the Court certainly appreciates their frustration, the Lankfords cannot keep their gains at the expense of other investors who lost everything.

The Trustee has established all elements of her claims to recover the Net Winnings VCR paid to the Lankfords, jointly, and David Lankford, individually, under 11 U.S.C. § 548(a)(1)(B) and N.M.S.A. 1978 § 56-10-18(A)(2). As discussed above, the asserted defenses will not prevent the Trustee from recovering the Net Winnings. The Trustee is therefore entitled to judgment in her favor against the Lankfords, jointly, in the amount of $45,939.32, and David

Lankford, individually, in the amount of $21,465.07, plus post-judgment interest at the federal judgment rate.

CONCLUSION

Based on the foregoing, the Trustee's Motions for Summary Judgment will be granted. The Trustee is entitled to avoid and recover all Net Winnings transferred to the Defendants. The Court will enter a separate judgment consistent with this memorandum opinion.

ROBERT H. JACOBVITZ
United States Bankruptcy Judge

Date entered on docket: May 27, 2014

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(Cite as: 326 B.R. 843)

United States Bankruptcy Court,
M.D. Florida,
Tampa Division.
In re McCARN'S ALLSTATE FINANCE, INC., Debtor(s).
Andrea P. Bauman, Chapter 7 Trustee, Plaintiff(s),
v.
Ray Bliese, Robert G. Burchette, Jr., Edward Camp, Richard V. Coyer, National Exchange, Inc., Defendants.

Bankruptcy No. 02–19766–8W7.
Adversary Nos. 03–0566, 03–0568, 03–0570, 03–0682, 03–0652.
June 30, 2005.

Background: Chapter 7 trustee brought adversary proceeding to avoid, as alleged fraudulent transfers, commission payments that debtor had made to brokers recruiting investors for alleged Ponzi scheme.

Holdings: The Bankruptcy Court, Michael G. Williamson, J., held that:
(1) debtor's guilty plea to allegations of information, which charged him with operating fraudulent scheme whereby "investors' funds were used to make interest and principal payments on promissory notes previously issued to other investors," was sufficient to establish that he had operated Ponzi scheme, and that commission payments that he made to brokers for procuring investors were made with actual intent to defraud creditors; and
(2) trustee could recover amount of transfers from initial transferees, i.e., from brokers who received transfers as commission payments, even if brokers had no knowledge whatsoever of fraudulent nature of underlying venture.

So ordered.

West Headnotes

[1] Bankruptcy 51 2644

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2644 k. Time of Making Transfer. Most Cited Cases

Bankruptcy 51 2649

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2649 k. Intent of Debtor. Most Cited Cases

Fraudulent Conveyances 186 8

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(A) Grounds of Invalidity in General
186k7 Elements of Fraud as to Creditors
186k8 k. In General. Most Cited Cases

Elements of cause of action to avoid transfer as actually fraudulent as to creditors under either bankruptcy fraudulent transfer statute or Florida law are: (1) transfer of property within requisite one- or four-year lookback periods; and (2) fact that transfer was made with actual intent to hinder, delay, or defraud entity to which debtor was indebted. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

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[2] Bankruptcy 51 2704

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2704 k. Trustee as Representative of Debtor or Creditors. Most Cited Cases

For bankruptcy trustee to use strong-arm powers to avoid transfer as actually fraudulent as to creditors under state law, trustee must establish that there exists at least one unsecured creditor of debtor who, when challenged transfer occurred, could have attacked and set transfer aside under applicable local law. Bankr.Code, 11 U.S.C.A. § 544(b).

[3] Bankruptcy 51 2704

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2704 k. Trustee as Representative of Debtor or Creditors. Most Cited Cases

Under strong-arm statute, trustee steps into shoes of creditor for purpose of asserting causes of action under state fraudulent conveyance laws. Bankr.Code, 11 U.S.C.A. § 544(b).

[4] Bankruptcy 51 2727(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2727 Weight and Sufficiency
51k2727(3) k. Fraudulent Transfers. Most Cited Cases

Fraudulent Conveyances 186 298(.5)

186 Fraudulent Conveyances
186III Remedies of Creditors and Purchasers
186III(I) Evidence
186k294 Weight and Sufficiency
186k298 Intent of Grantor
186k298(.5) k. In General. Most Cited Cases

Actual fraudulent intent, of kind required in order to avoid transfer as actually fraudulent as to creditors under fraudulent transfer provision of the Bankruptcy Code or Florida fraudulent transfer statute, is seldom proven by direct evidence, but is usually gleaned from inferences drawn from course of conduct. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

[5] Bankruptcy 51 2649

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2649 k. Intent of Debtor. Most Cited Cases

Fraudulent Conveyances 186 14

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(A) Grounds of Invalidity in General
186k13 Badges of Fraud
186k14 k. In General. Most Cited Cases

To determine whether circumstantial evidence supports inference that transfers were made with actual fraudulent intent, as required for avoidance thereof under fraudulent transfer provision of the

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Bankruptcy Code or Florida fraudulent transfer statute, courts look to badges of fraud. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

[6] Bankruptcy 51 2649

51 Bankruptcy
51V The Estate
51V(F) Fraudulent Transfers
51k2649 k. Intent of Debtor. Most Cited Cases

Bankruptcy 51 2727(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2727 Weight and Sufficiency
51k2727(3) k. Fraudulent Transfers. Most Cited Cases

Fraudulent Conveyances 186 9

186 Fraudulent Conveyances
186I Transfers and Transactions Invalid
186I(A) Grounds of Invalidity in General
186k7 Elements of Fraud as to Creditors
186k9 k. Intent. Most Cited Cases

Establishing existence of Ponzi scheme is sufficient to prove that transfers which debtor made in connection therewith were made with actual intent to defraud, of kind required by fraudulent transfer provision of the Bankruptcy Code and Florida fraudulent transfer statute. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

[7] Bankruptcy 51 2727(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2727 Weight and Sufficiency
51k2727(3) k. Fraudulent Transfers. Most Cited Cases

Fraudulent Conveyances 186 298(.5)

186 Fraudulent Conveyances
186III Remedies of Creditors and Purchasers
186III(I) Evidence
186k294 Weight and Sufficiency
186k298 Intent of Grantor
186k298(.5) k. In General. Most Cited Cases

Judgment 228 648

228 Judgment
228XIV Conclusiveness of Adjudication
228XIV(A) Judgments Conclusive in General
228k643 Nature of Action or Other Proceeding
228k648 k. Civil or Criminal Proceedings. Most Cited Cases

One way to establish existence of Ponzi scheme, for purpose of demonstrating that transfers made in connection therewith were actually fraudulent as to creditors and thus subject to avoidance under fraudulent transfer provision of the Bankruptcy Code or Florida fraudulent transfer statute, is through guilty plea to information or indictment that alleges facts sufficient to infer existence of Ponzi scheme. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

[8] Bankruptcy 51 2727(3)

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51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2727 Weight and Sufficiency
51k2727(3) k. Fraudulent Transfers. Most Cited Cases

Fraudulent Conveyances 186 298(.5)

186 Fraudulent Conveyances
186III Remedies of Creditors and Purchasers
186III(I) Evidence
186k294 Weight and Sufficiency
186k298 Intent of Grantor
186k298(.5) k. In General. Most Cited Cases

Judgment 228 648

228 Judgment
228XIV Conclusiveness of Adjudication
228XIV(A) Judgments Conclusive in General
228k643 Nature of Action or Other Proceeding
228k648 k. Civil or Criminal Proceedings. Most Cited Cases

Even if information or indictment did not specifically label debtor's fraud a "Ponzi scheme," evidence of guilty verdict or plea agreement admitting the charges can establish existence of Ponzi scheme, as well as the fraudulent nature of transfers made in connection therewith, where allegations in information establish that debtor ran scheme whereby it intended to defraud its creditors. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

[9] Bankruptcy 51 2727(3)

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)2 Proceedings
51k2725 Evidence
51k2727 Weight and Sufficiency
51k2727(3) k. Fraudulent Transfers. Most Cited Cases

Fraudulent Conveyances 186 298(.5)

186 Fraudulent Conveyances
186III Remedies of Creditors and Purchasers
186III(I) Evidence
186k294 Weight and Sufficiency
186k298 Intent of Grantor
186k298(.5) k. In General. Most Cited Cases

Judgment 228 648

228 Judgment
228XIV Conclusiveness of Adjudication
228XIV(A) Judgments Conclusive in General
228k643 Nature of Action or Other Proceeding
228k648 k. Civil or Criminal Proceedings. Most Cited Cases

Chapter 7 debtor's guilty plea to allegations of information, which charged him with operating fraudulent scheme whereby "investors' funds were used to make interest and principal payments on promissory notes previously issued to other investors," was sufficient to establish that he had operated Ponzi scheme, and that commission payments that he made to brokers for procuring investors were made with actual intent to defraud creditors, within meaning of fraudulent transfer provision of the Bankruptcy Code or Florida fraudulent transfer statute. Bankr.Code, 11 U.S.C.A. § 548(a)(1); West's F.S.A. § 726.105(1)(a).

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[10] Bankruptcy 51 ⇦2701

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2701 k. Avoidance Rights and Limits Thereon, in General. Most Cited Cases

Once Chapter 7 trustee demonstrated that alleged fraudulent transfers were avoidable on actual intent to defraud theory as transfers made in connection with debtor's Ponzi scheme, trustee could recover amount of transfers from initial transferees, i.e., from brokers who received transfers as commission payments, even if brokers had no knowledge whatsoever of fraudulent nature of underlying venture. Bankr.Code, 11 U.S.C.A. §§ 548, 550.

[11] Bankruptcy 51 ⇦2701

51 Bankruptcy
51V The Estate
51V(H) Avoidance Rights
51V(H)1 In General
51k2701 k. Avoidance Rights and Limits Thereon, in General. Most Cited Cases

Even an innocent initial transferee is liable for fraudulently transferred funds. Bankr.Code, 11 U.S.C.A. §§ 548, 550.

***845** Keith S. Shotzberger, Noel Boeke, Maegen E. Peek, Holland & Knight LLP, Tampa, FL, for Chapter 7 Trustee.

Roberta A. Colton, Nathan A. Carney, Trenam, Kemker, Scharf, Barkin, Frye, O'Neill & Mullis, P.A., Tampa, FL, for Defendant Edward Camp.

Herbert R. Donica, Tampa, FL, for Debtor.

MEMORANDUM OPINION ON MOTIONS FOR SUMMARY JUDGMENT

MICHAEL G. WILLIAMSON, Bankruptcy Judge.

A "Ponzi scheme" is a fraudulent investment arrangement in which returns to investors come from monies obtained from new investors rather than an underlying business enterprise. Establishing the existence of a Ponzi scheme is sufficient to prove a debtor's actual intent to defraud under either the Bankruptcy Code fraudulent transfer provision found in Bankruptcy Code section 548 or the Florida fraudulent transfer provision found in Florida Statutes section 726.105.

The Defendants in this adversary proceeding were brokers who received transfers***846** in the form of commissions for the initial sales and later renewals of investment notes. As the initial transferees of transfers made in connection with a fraudulent Ponzi scheme, the Defendants are liable to the Trustee for all of the commissions received in connection with the Ponzi scheme—even if they are completely innocent of any wrongdoing and even if they had no knowledge that the Debtor's investment program was a Ponzi scheme.

Accordingly, for the reasons set forth below, the Court will grant the motions for partial summary judgment as to the Trustee's prima facie case for each of the Defendants in this adversary proceeding. After entry of this order, the only issues remaining for trial will be any defenses raised by the Defendants.

Procedural and Factual Background

This is an adversary proceeding arising out of the chapter 7 bankruptcy case of McCarn's Allstate Finance, Inc. ("Debtor" or "Allstate"). This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. sections 157 and 1334, and 11 U.S.C. sections 544 and 548. This is a core proceeding under 28 U.S.C. section 157(b)(2)(A), (E) and (F).

This case came on for hearing on multiple motions for partial summary judgment brought by the Trustee for Allstate ("Trustee") against numerous Defendants. The Defendants were either brokerage companies or individual brokers who sold short-term promissory notes for the Debtor.

The Debtor's principal, James McCarn ("McCarn"), was the sole officer, shareholder, and director of two companies: Allstate and McCarn Enterprises, Inc. ("Enterprises"). McCarn incorporated Allstate ostensibly for the purpose of financing sub-prime automobile loans; he incorporated Enterprises as part of his auto loan business.

From mid–1994 through October 2002, McCarn, through the two companies, offered and sold millions of dollars worth of unregistered, unsecured promissory notes (collectively, the "Notes") to over 600 investors in several states (the "Investors"). Each Allstate Note was for a nine-month term and was represented to pay 9 percent interest on an annualized basis.

To solicit customers to purchase the Notes, McCarn used various selling agents ("Brokers") who he paid commissions upon the initial sale of each Note. When an Investor bought a nine-month Note from Allstate, the Investor paid the face value of the Note to Allstate. In return, the Investor received a Note issued by Allstate and signed by McCarn. Investors also received a Purchaser's Receipt (the "Receipt"), which contained the following notice: "Repurchase notices are sent one month prior to maturity. If Allstate Finance, Inc. does not hear from the purchaser by the maturity date, Allstate Finance, Inc. is authorized to continue the Promissory Note 'as is' " ("Notice").

As a result, the Notes generally automatically renewed in accordance with the terms of the Receipt thus avoiding the repayment of principal. Whenever a Note automatically renewed, Allstate generally paid an additional commission to the Broker who originally sold the Note, even though the Broker did not solicit the renewal. Investors had the option of receiving their interest monthly or, as many Investors chose, receiving their interest checks at the end of the nine-month term. McCarn, through Allstate, used the proceeds from the sale of Notes to new Investors to pay off interest and principal to earlier Investors.

By mid–2002, Allstate's scheme collapsed due to its inability to raise enough money to sustain and to perpetuate the ***847** scheme. In July 2002, several Investors filed a petition for involuntary bankruptcy against Enterprises when the Investors failed to receive their interest payments. This Court entered an order for relief against Enterprises and appointed Andrea P. Bauman as Trustee in September 2002. One month later, Allstate filed a voluntary petition. On October 11, 2002, this Court entered an order converting Allstate's Chapter 11 case to one under chapter 7 of the Bankruptcy Code. Andrea P. Bauman has also been appointed the chapter 7 trustee in Allstate's Chapter 7 case.

Meanwhile, in September 2003, the United States Attorney for the Middle District of Florida filed a two-count Information ("Information") against McCarn alleging, among other things, that:

> 5. Beginning on an unknown date, but at least as early as in or about August 1995, and continuing thereafter, through and including October 7, 2002, within the Middle District of Florida, the District of Nevada, and elsewhere,
>
> JAMES HOYLE McCARN,
>
> the defendant herein, did unlawfully, knowingly and willfully, combine, conspire, confederate and agree with other individuals, both known and unknown, to commit certain offenses against the United States,

specifically:

a. To execute and attempt to execute a scheme to defraud and engage in acts and practices which operate as a fraud or deceit in connection with the purchase and sale of securities, utilizing the means and instrumentalities of interstate commerce and the United States mail, in violation of Title 15, United States Code, Section 78j(b); and

b. To execute and attempt to execute a scheme and artifice to defraud, and for obtaining money from investment customers by false and fraudulent pretenses, representations, and promises, utilizing the Unites States mail and private and commercial carriers, in violation of Title 18, United States Code, Section 1341.

. . . . .

12. It was a further part of the conspiracy that the defendant and coconspirators would and did omit to state in the brochures, bi-fold question and answer pamphlets, and other materials advertising investment opportunities in the nine-month promissory notes, the material fact that the investors' funds were utilized for purposes other than operations of MAF.

13. It was a further part of the conspiracy that the defendant and coconspirators would and did omit to state in the brochures, bi-fold question and answer pamphlets, and other materials advertising investment opportunities in the nine-month promissory notes, the material fact that investors' funds were used to pay for commissions, salaries, and personal expenses and to make loans to other entities controlled by defendant.

14. It was a further part of the conspiracy that the defendant and coconspirators would and did omit to state in the brochures, bi-fold question and answer pamphlets, and other materials advertising investment opportunities in the nine-month promissory notes, the material fact that investors' funds were used to make interest and principal payments on promissory notes previously issued to other investors.

On September 26, 2003, McCarn pleaded guilty to both counts of the Information.

After discovering the fraudulent nature of McCarn's business, the Trustee filed these adversary proceedings in October 2003 pursuant to sections 544, 548, and 550 ***848** of the Bankruptcy Code and chapter 726 of the Florida Statutes. The complaints, filed against both individual brokers and brokerage firms, seek to avoid what the Trustee alleges were actual and constructively fraudulent transfers in the form of commissions paid by the Debtor to the Defendants.

Conclusions of Law

Ponzi schemes inevitably end up in bankruptcy court leaving behind numerous victims—many of whom invested their life savings in the scheme without any knowledge of its fraudulent nature. Although a chapter 7 trustee can often recover some of the fraudulently acquired funds from the assets of the debtor and the debtor's insiders, in most cases those assets fall woefully short of the victims' losses. This leads to adversary proceedings such as these that seek recovery against others, who, while innocent of any wrongdoing, were nevertheless involved in procuring the investors.

When the trustee brings an action against such third parties, a common theme runs through their responses—that is, they too were victims of the debtor's fraudulent conduct. Defendants filed similar responses in this case. For example, Defendant Robert Burchette writes, "I *could not* have known what was going on—the following did not know [naming, among others, the Department of Banking & Finance

of the State of Florida] ... HOW COULD I HAVE KNOWN! All of the above did not have a clue—WHY ME!" Answer of Robert Burchette, Adv. Proc. No. 03–0568 (emphasis in original).

For the answer to Mr. Burchette's plea and similar pleas of the other Defendants, the Court must look to the language of the fraudulent conveyance statutes upon which the Trustee has based her case. Specifically, the Trustee alleges that the commissions Debtor paid to the Defendants constituted actual fraudulent transfers under Bankruptcy Code section 548(a)(1) and the state law fraudulent transfer statute, Florida Statutes section 726.105(1)(a). Under the Trustee's theory, once the Court concludes that the transfers made by McCarn's were part of a Ponzi scheme, then the Trustee may recover against the initial transferees of the transfers—in this case the brokers who received their commission checks—even if the brokers had no knowledge whatsoever of the fraudulent nature of the underlying venture.

1. Elements of the Trustee's Prima Facie Case

[1] The elements of a case under Bankruptcy Code section 548 and Florida Statutes section 726.105(1)(a), are as follows:

a. The debtor must have transferred the property within one year (under section 548) or four years (under section 726.105) of filing of the bankruptcy petition. In this case, the involuntary bankruptcy petition was filed on October 7, 2002.

b. The transfer must have been made with the actual intent to hinder, delay, or defraud any entity to which the debtor was indebted. 11 U.S.C. § 548(a)(1); Fla. Stat. § 726.105(1)(a).

[2][3] In addition, in order for the Trustee to use the provisions of the Florida fraudulent conveyance statute found in section 726.105(1)(a), with its more favorable four-year, look-back period, the Trustee must meet the condition found in Bankruptcy Code section 544(b) that there exist "at least one unsecured creditor of the Debtor who at the time the transfer in question occurred could have, under applicable local law, attacked and set aside the transfer under consideration." ***849***In re Smith,* 120 B.R. 588, 590 (Bankr.M.D.Fla.1990) (citations omitted). Under section 544(b), the Trustee "step[s] into the shoes of a creditor for the purpose of asserting causes of action under state fraudulent conveyance laws and confers on the trustee the status of a hypothetical creditor or bona fide purchaser as of the commencement of the case." *Matter of Zedda,* 103 F.3d 1195, 1201 (5th Cir.1997). *See also In re Kaufman Roberts, Inc.,* 188 B.R. 309, 313 (Bankr.S.D.Fla.1995).

There is no dispute in this case about the existence of unsecured creditors on the dates of the transfers involved in this adversary proceeding. Therefore, the Trustee has satisfied this burden. As discussed below, this was a Ponzi scheme in which numerous creditors were defrauded from its inception. Many of the over 800 creditors that filed claims in this case could have brought an action to recover funds fraudulently transferred by the Debtor under Florida Statutes section 726.105(1)(a). *See, e.g., Wilson v. Wilson,* No. 03–00780, 2004 WL 2671678, at *4 (Bankr.N.D.Iowa Nov.12, 2004) ("Eight creditors filed proofs of claim after receiving notice that assets exist for distribution. Thus, the record in the bankruptcy case is sufficient to prove the existence of a creditor holding an unsecured claim under § 544(b)."); *In re Imageset, Inc.,* 299 B.R. 709, 715 (Bankr.D.Me.2003) ("[the trustee] has submitted copies of proofs of claim filed by nine of those twenty-three creditors [and because the proof was not rebutted, summary judgment was entered on the existence of an unsecured creditor]."); *In re Int'l Loan Network, Inc.,* 160 B.R. 1, 18 (Bankr.D.D.C.1993) ("At least 15,000 proofs of claims (the vast majority being unsecured claims) have been filed against the ILN estate, some evidencing unsecured claims that arose as early as February 1989. Therefore the trustee has met his burden of establishing that at least one

unsecured creditor exists [ ] who could bring a claim.").

2. Proving Actual Fraud under Bankruptcy Code section 548(a)(1) and Florida Statutes section 726.105(1)(a)

As an initial matter, Bankruptcy Code section 548 and Florida Statutes section 726.105 are substantially the same, and both address claims under the same legal framework. *See In re Toy King Distributors, Inc.,* 256 B.R. 1, 126–27, 143 (Bankr.M.D.Fla.2000) (treating § 726.105 as state law equivalent of 11 U.S.C. § 548(a)(1)(A) and treating § 726.106 as state law equivalent of § 548(a)(1)(B)); *In re Stewart,* 280 B.R. 268, 273 (Bankr.M.D.Fla.2001) (holding that § 548 and § 726.105 "are analogous 'in form and substance' and may be analyzed contemporaneously.") (citing *In re Venice–Oxford Assoc. Ltd,* 236 B.R. 820, 834 (Bankr.M.D.Fla.1999)); *In re Randy,* 189 B.R. 425, 443 (Bankr.N.D.Ill.1995) (finding that "[s]ince § 548 of the Bankruptcy Code and §§ 5 and 6(a) of UFTA are analogous, the findings regarding § 548(a)(1) and (a)(2) apply identically to the requirements of [the Uniform Fraudulent Transfer Act]" (citing Collier on Bankruptcy, ¶ 548.01 (15th Ed.1992)); *In re United Energy Corp.,* 944 F.2d 589, 594 (9th Cir.1991)). Therefore, the analysis of what must be shown to prove actual fraud under both the bankruptcy and state law fraudulent transfer provisions is the same.

[4][5] "Actual fraud [under either statute] is seldom proven by direct evidence." *Toy King Distributors,* 256 B.R. at 127. Instead, it is usually "gleamed [sic] from inferences drawn from a course of conduct." *Id.* at 127–28 (quoting *In re F & C Servs., Inc.,* 44 B.R. 863, 872 (Bankr.S.D.Fla.1984)). "To determine whether circumstantial evidence supports an inference of intent," in most cases, courts look ***850** to "badges of fraud." *Id.* at 128. The Eleventh Circuit has adopted the badges of fraud contained in the Florida fraudulent transfer statute. *In re Levine,* 134 F.3d 1046, 1053 (11th Cir.1998).[FN1]

FN1. The badges include:

(a) The transfer or obligation was to an insider.

(b) The debtor retained possession or control of the property transferred after the transfer.

(c) The transfer or obligation was disclosed or concealed.

(d) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.

(e) The transfer was of substantially all the debtor's assets.

(f) The debtor absconded.

(g) The debtor removed or concealed assets.

(h) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.

(i) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation incurred.

(j) The transfer occurred shortly before or shortly after a substantial debt was incurred.

(k) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the

> debtor.
>
> *Id.* (citing Fla. Stat. § 726.105(2)).

[6] However, while badges of fraud are often helpful, bankruptcy courts nationwide have recognized that establishing the existence of a Ponzi scheme is sufficient to prove a Debtor's actual intent to defraud. A Ponzi scheme is defined as follows:

> [A] fraudulent investment arrangement in which returns to investors are not obtained from any underlying business venture but are taken from monies received from new investors. Typically, investors are promised high rates of return, and initial investors obtain a greater amount of money from the ponzi scheme than those who join the ponzi scheme later. As a result of the absence of sufficient, or any, assets able to generate funds necessary to pay the promised returns, the success of such a scheme guarantees its demise because the operator must attract more and more funds, which thereby creates a greater need for funds to pay previous investors, all of which ultimately causes the scheme to collapse.

In re Taubman, 160 B.R. 964, 978 (Bankr.S.D.Ohio 1993) (citations omitted).

In *In re Independent Clearing House, Co.,* 77 B.R. 843 (D.Utah 1987), the District Court of Utah best explains why finding the existence of a Ponzi scheme establishes actual intent:

> 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. Knowledge to a substantial certainty constitutes intent in the eyes of the law, *cf. Restatement (Second) of Torts* § 8A (1963 & 1964), and a debtor's knowledge that future investors will not be paid is sufficient to establish his actual intent to defraud them.

Id. at 860. Multiple courts have reached the same conclusion. *See, e.g., Scholes v. Lehmann,* 56 F.3d 750, 757 (7th Cir.1995); *In re Agricultural Research and Tech. Group,* Inc., 916 F.2d 528, 535 (9th Cir.1990); *Conroy v. Shott,* 9 Ohio Misc. 117, 363 F.2d 90, 92 (6th Cir.1966); *In re World Vision Entm't, Inc.,* 275 B.R. 641, 656 (Bankr.M.D.Fla.2002); ***851***In re C.F. Foods, L.P.,* 280 B.R. 103, 111 (Bankr.E.D.Pa.2002) ; *In re Armstrong,* 217 B.R. 569, 574 (Bankr.E.D.Ark.1998); *In re M & L Bus. Mach. Co., Inc.,* 198 B.R. 800, 806 (Bankr.D.Colo.1996); *In re Cohen,* 199 B.R. 709, 717 (9th Cir. BAP 1996); *In re Foos,* 188 B.R. 239, 244 (Bankr.N.D.Ill.1995); *Randy,* 189 B.R. at 439; *Taubman,* 160 B.R. at 983.

[7] One way to establish the existence of a Ponzi scheme is through a guilty plea to an information or indictment that alleges facts sufficient to infer the existence of a Ponzi scheme. *See Scholes,* 56 F.3d at 762 (holding that debtor's plea agreement, admitting charges of fraud, established existence of Ponzi scheme); *In re Mark Benskin & Co., Inc.,* 161 B.R. 644, 648–49 (Bankr.W.D.Tenn.1993) (noting as part of finding that guilty pleas prove by preponderance of the evidence actual intent to defraud that the indictment "clearly allege[d] a scheme ... to defraud creditors ... by pleading guilty the debtors admitted, among other things, misappropriation of customers' [ ] funds and misrepresentation of the status of or return on their investments.").

[8] Even if the information or indictment did not specifically label the fraud a "Ponzi scheme," if the allegations in the information establish that the debtor ran a scheme whereby the debtor intended to defraud the debtor's creditors, evidence of a guilty verdict or

plea agreement admitting the charges can establish the existence of a Ponzi scheme. *See In re Ramirez Rodriguez,* 209 B.R. 424, 433 (Bankr.S.D.Tex.1997) (holding that debtor's criminal conviction based on the operation of a Ponzi scheme conclusively established fraudulent intent); *Randy,* 189 B.R. at 439 (same); *Benskin & Co.,* 161 B.R. at 648 (same). *See al* so *C.F. Foods,* 280 B.R. at 111 (citing generally to both ideas with approval).

[9] The Information entered against McCarn alleges that McCarn committed acts commensurate with the definition of a Ponzi scheme. The Information alleges that McCarn "execute[d] and attempt[ed] to execute a scheme to defraud and engage in acts and practices which operate as a fraud or deceit in connection with the purchase and sale of securities...." Information at ¶ 5(a). Additionally, the Information alleges that McCarn executed his fraudulent scheme by "obtaining money from investment customers by false and fraudulent pretenses, representations, and promises...." *Id.* at ¶ 5(b). More specifically, the Information alleges that McCarn sold securities to investors without telling the investors that their money was being "used to pay for commissions, salaries, and personal expenses and to make loans to other entities controlled by [McCarn]." *Id.* at ¶ 13. The Information also alleges that the "investors' funds were used to make interest and principal payments on promissory notes previously issued to other investors." *Id.* at ¶ 14.

These allegations are sufficient to establish the existence of a Ponzi scheme. Because McCarn (as sole shareholder, officer, and director of Allstate) admitted and pleaded guilty to all the allegations in the Information, he has admitted to creating and running a Ponzi scheme. As the case law above recognizes, a debtor who runs a Ponzi scheme knows that his future investors will lose their money and "a debtor's knowledge that future investors will not be paid is sufficient to establish his actual intent to defraud them." *Independent Clearing House,* 77 B.R. at 860. Therefore, the Trustee has established the Debtor's actual intent to defraud under Bankruptcy Code section 548(a)(1)(A) and Florida Statutes section 726.105(1)(a).

Once it is established that the Investors' funds were transferred by Debtor as part ***852** of a Ponzi scheme, the Trustee has met her burden with respect to avoiding those transfers so long as they were made within either the one-year or the four-year, look-back periods contained in Bankruptcy Code section 548 or Florida Statutes section 726.105, respectively. In this case, no defendant has disputed that the transfers that the Trustee is seeking to avoid took place within the applicable look-back periods.

Thus, the Trustee has proven that the transfers were made within the applicable look-back period from the date of the Debtor's bankruptcy filing and that the transfers were made with actual intent to hinder, defraud, or delay creditors. The transfers, as listed in the motions for summary judgment, are therefore subject to avoidance under Bankruptcy Code section 548 and Florida Statutes section 726.105.

3. Defendants' Liability as Initial Transferees under 11 U.S.C § 550(a)

[10] Once a court determines that transfers are avoidable under Bankruptcy Code section 548 or under Florida Statutes section 726.105, (available to the Trustee under Bankruptcy Code section 544(b)), the Court must then look to Bankruptcy Code section 550 to determine the liability of the transferee of the avoided transfer. In this regard, section 550 provides that "to the extent that a transfer is avoided under section 544 [or] ... 548, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from ... the initial transferee of such transfer...." 11 U.S.C. § 550(a)(1).

The Trustee does not dispute the Defendants' assertions that they were completely innocent of any

wrongdoing and that they had no knowledge of the fraudulent nature of the Debtor's Ponzi scheme. Unfortunately for these Defendants, "[n]either innocence in action nor unfairness in result is a defense." *In re Mainely Payroll, Inc.,* 233 B.R. 591, 597 (Bankr.D.Me.1999). "The statute leaves no room to fashion a remedy that treats the initial transferee equitably under the circumstances of any given case." *Id.* at fn. 7 (citing *Bowers v. Atlanta Motor Speedway, Inc. (In re Southeast Hotel Properties Ltd.),* 99 F.3d 151, 157 (4th Cir.1996) ([D]ecisions as to who should bear the loss incurred by a post-petition transfer are made in the Code.); *Rupp v. Markgraf,* 95 F.3d 936, 944 (10th Cir.1996) (Congress has made its own judgment of who should bear the risk of loss under [sic] these situations when it enacted Section 550, and [the court is] bound to accept that judgment.); *Bonded Fin. Servs., Inc. v. European Am. Bank,* 838 F.2d 890, 894–95 (7th Cir.1988) (rejecting an approach that would treat any entity that handles the debtor's assets as an initial transferee and then bail out the deserving through an unwarranted extension of equity); *Richardson v. F.D.I.C. (In re M. Blackburn Mitchell Inc.),* 164 B.R. 117, 123 (Bankr.N.D.Cal.1994) ([T]he Court declines to manipulate the application of the Code [550] in order to achieve what some may contend is a preferred result.); *Id.* at 125 (The Court concludes that it is irrelevant as a matter of law that the [defendant] did not have knowledge, or reason to believe, that the funds it received flowed from Debtor's account. Under 550 of the Bankruptcy Code, it is crystal clear that even the "innocent" initial transferee is liable for the fraudulently transferred funds.); *see also In re Finley,* 130 F.3d 52, 56 (2d Cir.1997) (describing practice of some courts that regard the first pair of hands to touch the property [as] the initial transferee, and then go on to separate sheep from goats in an attempt to work equity); *see generally* Kenneth P. Coleman, ***853***Conduits, Good Faith, and the Recovery of Preferences and Fraudulent Transfers Under Bankruptcy Code Section 550,* 114 Banking L.J. 375 (1997) (analyzing Rupp)).

[11] The Court concludes, therefore, that it is irrelevant as a matter of law that the Defendants did not have knowledge of the Ponzi scheme. That is, under section 550, "it is crystal clear that even the 'innocent' initial transferee is liable for the fraudulently transferred funds." *M. Blackburn Mitchell,* 164 B.R. at 125.

No Defendant has disputed the Trustee's allegation that he or she was an initial transferee. Thus, the Trustee has successfully proven that the Defendants were initial transferees within the meaning of section 550(a).

Conclusion

Through a series of motions for partial summary judgment, the Trustee has proven all the necessary elements to avoid the transfers by the Debtor to the Defendants under Bankruptcy Code section 548 and under Bankruptcy Code section 544(b) via Florida Statutes section 726.105(1)(a). Specifically:

(a) The Trustee has proven that the Debtor made transfers to the Defendants listed in the respective motions for summary judgment and that the Defendants were the initial transferees within the meaning of 11 U.S.C. § 550(a)(1);

(b) The Trustee has proven that the transfers set forth in the motions for summary judgment were made within one year (for purposes of Bankruptcy Code section 548) or four years (for purposes of Florida Statutes section 726.105(1)(a)) before the date of the filing of the petition;

(c) The Trustee has proven that the transfers were made with actual intent to hinder, delay, or defraud the Debtor's creditors; and

(d) In satisfaction of Bankruptcy Code section 544(b) for purposes of utilizing Florida Statutes section 726.105(1)(a), the Trustee has proven the existence of at least one unsecured creditor who could have

brought these claims.

Thus, the Trustee has proven all the elements necessary to establish that the transfers listed in the motions for summary judgment are avoidable as fraudulent under Bankruptcy Code section 548 or Florida Statutes section 726.105. The amounts transferred are therefore recoverable for the benefit of the Estate in accordance with Bankruptcy Code section 550. The only issues remaining for trial are any defenses the Defendants might raise.

The Court will enter separate orders granting the motions for summary judgment in each of these adversary proceedings.

DONE and ORDERED in Tampa, Florida, this 30th day of June, 2005.

Bkrtcy.M.D.Fla.,2005.
In re McCarn's Allstate Finance, Inc.
326 B.R. 843, 44 Bankr.Ct.Dec. 275, 18 Fla. L. Weekly Fed. B 287

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