Appealed; See #185

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UNPUBLISHED OPINION

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

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IN RE:	)	Bankruptcy No. 81A-02887
UNIVERSAL CLEARING HOUSE COMPANY, a Trust, aka NATIONAL CLEARING HOUSE COMPANY, a Trust,	)	
Debtor.	)	
INDEPENDENT CLEARING HOUSE COMPANY, a Trust,	)	Bankruptcy No. 81A-02886
Debtor.	)	
ACCOUNTING SERVICES COMPANY, a Trust,	)	Bankruptcy No. 81A-03704
Debtor.	)	
ROBERT D. MERRILL, Trustee,	)	Adversary Proceeding No. 82PA-0253
Plaintiff,	)	
vs.	)	
CHAD ALLEN, et al,	)	Civil No. C-83-0157W-01
Defendants.	)	

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MEMORANDUM OPINION

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APPEARANCES

William G. Fowler, and Ronald W. Goss, Roe & Fowler, Salt Lake City, Utah, for the plaintiff-trustee, Robert D. Merrill; Daniel W. Jackson, Salt Lake City, Utah, for defendants Glen Wright, Larry Wright, Ed Miller and Ron Fish; Reed M. Richards, Richards, Caine &

Richards, Ogden, Utah, for defendant Cyril Stevenson; Joseph C. Fratto Jr., Salt Lake City, Utah, for defendant Harry B. Young; Kim Crowther, pro se; Al Toronto, pro se.

CASE SUMMARY

This matter is before the Court on the trustee's motion for summary judgment. The Court must decide whether commission payments received by sales agents of the debtors for soliciting and servicing investments in a "Ponzi" scheme may be set aside and recovered for the benefit of the debtors' bankruptcy estate. For the reasons hereinafter set forth, it is the opinion of this Court that such payments constitute fraudulent conveyances and may be avoided by the trustee.

BACKGROUND

This proceeding arises out of the business and activities of Independent Clearing House and Universal Clearing House, which filed voluntary petitions for relief under Chapter 11 on September 16, 1981.[1] The trustee commenced this adversary proceeding to recover payments made by the debtor to 127 individuals and entities, based

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[1] For a more detailed discussion of those activities, see In re Independent Clearing House, 41 B.R. 985 (Bkrtcy. D. Utah 1984).

upon averments that such payments constituted commissions received for inducing investors to invest money in the debtors' "Ponzi" scheme, and are transfers avoidable by the trustee.

On February 21, 1984, the trustee filed a motion for summary judgment supported by the affidavits of Dr. Ron N. Bagley, accountant for the trustee, and William S. Skeen, a former sales agent of the debtors' investment contracts. Hearings were held on March 12 and May 29, 1984, to consider the trustee's motion and the objections of various defendants, and the matter was taken under advisement.

UNDISPUTED FACTS

Based upon the pleadings, answers to interrogatories and affidavits on file in the proceeding, there is no genuine issue as to any of the following material facts:

(1) Independent Clearing House Company and Universal Clearing House Company filed voluntary petitions for relief under Chapter 11 on September 16, 1981.

(2) The stated business purpose of the Clearing Houses was to solicit funds from private investors, who were characterized as "undertakers", and to use the invested funds for the purpose of assuming and paying the accounts payable of various client companies. Profits were to be obtained through negotiating discounts with

creditors of the client companies; the margin of profit being the difference between the discounts negotiated with the creditors and the sums repaid by the client companies.

(3) Commencing in 1980, the debtors began soliciting investments from private investors through sales agents, including the defendants herein.

(4) Each sales agent's commissions were determined by the aggregate dollar value of the investments he or she solicited.

(5) In 1980 and 1981, several thousand investors deposited sums totaling more than 29 million dollars with the debtors.

(6) Between October, 1980, and August, 1981, the sales agents received approximately three million dollars in commission payments.

(7) Each of the sales agents recieved training instructions in the manner of conducting sales programs or presentations for potential investors.

(8) The services for which the agents received commissions consisted of recieving training and learning how to explain the program and solicit investments from prospective investors and explaining the investment program to them; delivering signed investment contracts together with the investor's money to their

supervisors for approval and acceptance; delivering monthly earnings checks from the debtors to investors; maintaining contact with their supervisors; and answering questions from investors and potential investors relating to the program.

(9) In connection with the foregoing activities, the sales agents incurred out-of-pocket expenses for which they were not reimbursed by the debtors.

(10) None of the sales agents obtained factual information from the principals of the debtors verifying the existence of actual client companies, which were the basis of the purported accounts payable program and whose accounts were actually paid by the debtors.

(11) None of the sales agents had actual knowledge that the purported accounts payable program did not actually exist.

(12) No client companies existed whose accounts payable were paid by the debtors in accordance with the representations made to investors, and no profits were ever produced by the program.

(13) The debtors were insolvent from the commencement of their investment program, and became more insolvent with each successive investment solicited by the sales agents.

(14) The business of the debtors was conducted as a "Ponzi" scheme in which fictitious profits and commissions were paid to the investors and sales agents, respectively, from principal sums deposited by later investors.

(15) Within one year before the debtors filed petition for relief under Chapter 11, they transferred commission payments to the defendants, as follows:

Dean Anson	$ 5,084.00
David Ashby, dba K.D. Marketing	234,326.81
Dennis Ashby, dba D.&D. Marketing	15,707.60
Sam Aston, dba Diablo Valley Consultants	19,253.60
Dave Baker	4,106.75
Val Bentley, dba Motherlode Consultants	478,697.96
Rudy Bishof, dba Capital Management Consultants	51,560.50
Monty Brown	4,502.60
Enroque Cavazos	6,472.50
David Chalk	25,551.80
Joe Chapman, dba Western Mangement Consultants	57,138.00
Jerry Christensen, dba C. & C. Associates	9,495.00
Moira & Chuck Henderson, dba Enterprises	53,067.94
Earl Cox	4,314.70
Kim Crowther, dba J.B. Enterprises	29,367.26
Sheldon Dixon, dba S. & D. Company	3,846.00
Mike Findeis	2,756.42
Ron Fish, dba "F" Street	19,344.66
Neil Pickard, dba Focus Enterprises	300.00
Ron Foltz, dba Professional Management	20,369.00
Randy Frisch	4,676.00
Tom Garza, dba American Investment and Bella Enterprises	11,448.50
Lamont Gibson	7,629.80
Harvey Greer	10,716.91
Mel Harris	60,642.00
Randy Hofstar, dba Fiscal	8,416.00

Management Consultants	
Keith Julian, dba Homes & Short & New Horizons	77,064.88
David Howard	330.00
Jery Huish, dba Pro Company	51,839.87
Frank Gunderson, dba J. & G. Company	3,360.00
Greg Johns	6,830.50
Eusebio Limas	1,705.00
Tom Malin	2,885.20
David Manning, dba Starwest	259,627.24
Earl Manning	50,052.00
Glen Manning	32,267.30
Keith Manning	1,044.00
Lee Manning	7,398.40
Ray Manning	14,997.80
Ed Miller, dba Cambridge Consultants	20,238.00
Harold Mills	4,538.10
Robert Mixdorf, dba Beecie Enterprises	82,401.13
Jerry Nerdin, dba Diversified Marketing	19,347.59
Don Nelson	37,511.85
Gene Parrish	5,893.00
Devon Pearson	3,576.00
Ezequiel Perez	2,938.00
James Raymer	8,852.50
Victor Reese	19,526.53
William Roskelly, dba Idaho Mountain	53,197.61
R.J. Rucker	18,413.00
Calvin Sanders	24,206.00
Detsel Parkinson, dba Selco	20,666.29
Ronald Schuler	14,180.00
Cyril Stevenson, dba Daws Properties	20,000.00
Cary Toone	9,011.50
Shannon and Shawn Torgler	2,608.50
Al Toronto, dba Alpine Enterprises	284,157.92
Robert Vaughn	6,465.18
Larry Wayman	15,087.60
Larry Wright	12,275.25
Glen Wright, dba GM Enterprises	263,464.41

DECISION

This case presents an unusual legal problem which has not been addressed in a reported decision in nearly 60 years. The Court must determine the value of services rendered by sales agents in soliciting and handling investments in the debtor's "Ponzi" scheme.[2]

The four elements of a fraudulent conveyance under 11 U.S.C. §548(a)(2) are:

(1) A transfer of an interest of the debtor in property;

(2) The transfer occurred within one year of the filing of the bankruptcy petition;

(3) The debtor was insolvent on the date of the transfer or became insolvent as a result thereof; and

(4) The debtor received less than a reasonably equivalent value in exchange for the transfer.[3]

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2 The Court has read and considered the memoranda filed by the defendants in connection with this proceeding, and has determined that the arguments, except as they bear on the question of valuation of the defendants' services, are without merit.

3 Pursuant to Section 544(b) of the Bankruptcy Code, the trustee may assert applicable state law to avoid transfers in fraud of creditors. The applicable state law in this case is the Uniform Fraudulent Conveyances Act, which is codified at Utah Code Ann §25-1-1 et seq (Repl. 1984), Section 548 of the Bankruptcy Act, is a near copy of the Uniform Fraudulent Conveyances Act.

The existence of the first three elements is not in question. The trustee's claims turn, therefore, on whether the debtor received less than a reasonably equivalent value in exchange for the transfers.

There is no precise formula for determining what constitutes a reasonably equivalent value. See Rosenberg v. Trautwein, 624 F.2d 66, 666, 669 (5th Cir. 1980); Klein v. Tavatchnick, 610 F.2d 1043, 1047-48 (2d Cir. 1979); Roth v. Fabrikant Bros., 175 F.2d 665, 667-68 (2d Cir. 1949). It is "hard to stretch the idea beyond the facts and circumstances of each particular case." G. Glenn, "Creditors Rights--A Review of Recent Developments," 32 Va. L. Rev. 236, 247-48 (1946) (discussing "fair consideration"). In each case, the court must consider the transfer from the standpoint of creditors and weigh the public policy of upholding the integrity of the debtor's legitimate prepetition transactions against the fundamental bankruptcy policy of preventing debtors from putting realizable assets beyond the reach of their creditors. Since creditors are unable to control the amount of consideration which the prepetition debtor will accept in conveying its assets, the Bankruptcy Code permits the trustee, as the creditors' representative, to reexamine the adequacy of the consideration and set aside transactions where there is a great disparity between the consideration received and the property trans-

ferred by the debtor. Where the consideration is approximately equal to the value recieved at the time of the conveyance, it must, of course, be considered fair.

Where there is a question as to the sufficiency of the services as compared to the value of the property transferred, the Court must determine from the evidence what the services rendered were worth. Defendants argue that they should be allowed to present evidence to establish their right to a reasonable commission on the basis of quantum meruit. The Court disagrees. I am of the opinion that the decision of the district court in In re Ponzi, 15 F.2d 113 (D. Mass. 1926), states the proper approach to the issue of valuation regarding the services performed by the debtors' operatives in furthering a "Ponzi" scheme.[4]

In In re Ponzi, a sales agent employed by Charles Ponzi had invested his commissions in Ponzi's notes, not knowing that the investment scheme was a fraud. After Ponzi was adjudged a bankrupt, the agent sought allowance of his claim. The referee disallowed the claim on the ground that the payment of commissions by Ponzi were transfers in fraud of creditors, and the claimant sought review by

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4 For the definition of "Ponzi" scheme and a brief summary of the criminal career of Charles Ponzi, see In re Independent Clearing House, supra, 41 B.R. at 994 n.12.

the district court. The district court did not dispute the claimant's contention that he had sold Ponzi's notes to investors in good faith without knowledge of the underlying fraud.

> Ponzi's notes were swindles, but the claimant did not realize this. He accepted Ponzi's statements and passed them along in good faith to the persons to whom he sold. The situation is analogous to one in which fake precious stones have been sold as genuine by an agent unaware of the fraud which his principal was perpetrating. Would he be entitled to retain against the creditors in bankruptcy of the principal the sums received by him for such services.

Id. at 114

The district court analyzed the services rendered by the sales agent in order to value such services, as follows:

> [T]he claimant's honest belief, that his services to Ponzi in selling the latter's notes were valuable does not alter the fact that those services were not valuable, but, quite the contrary, were actually detrimental, because they furthered the commission of a crime and deepened Ponzi's insolvency.

Id.

In all of the above particulars, I think the district court's reasoning as to the existence and adequacy of the sales agent's consideration was correct. Those services, like those rendered by the defendants in this case were without legally cognizable value. Therefore, the trustee is entitled to summary judgment for the amounts set forth, together with prejudgment interest from the

commencement of this action. The trustee shall prepare and submit separate judgments in accordance with Local Rule 13 within fifteen (15) days.

Dated this 3 day of May, 1985.

JOHN H. ALLEN
UNITED STATES BANKRUPTCY JUDGE