

The ClawBack Report

A Preference and Fraudulent Conveyance Newsletter

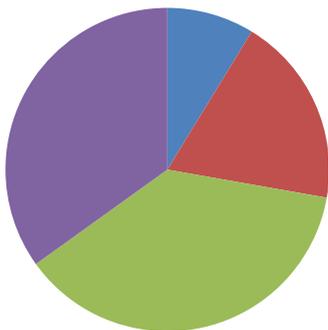
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Groups of Adversary Proceedings Filed by the Debtors



- Gravity-Ratterman, LLC
- Gulf Packaging, Inc.
- Health Diagnostic Laboratory, Inc.
- The Truland Group, Inc.

INTRODUCTION

Your monthly dispatch from the clawback wars by Roland Gary Jones Esq., “The Clawback Guy”.

Trustees initiated more than **250** adversary proceedings nationwide during the month of July 2016. Most notable -

- **94** clawback lawsuits initiated in the bankruptcy cases of **Health Diagnostic Laboratory, Inc.**
- **88** preference actions were commenced in **The Truland Group, Inc.** bankruptcy.

Rulings for July –

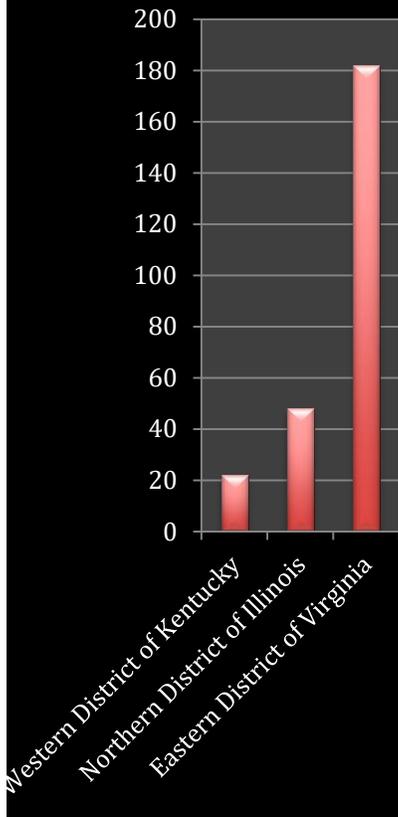
- The United States District Court for the Southern District of New York reversed a bankruptcy court decision that had dismissed actual fraudulent transfer claims arising out of a failed leveraged buyout. In reversing the bankruptcy court, the Court held that a trustee can proceed on its actual fraudulent transfer claims against the shareholders of a company on the basis of the fraudulent intent of the company’s director, which intent may be imputed to the company.
- A Delaware Bankruptcy Court allowed the defendant to utilize a post-petition administrative claim to set off its preference liability. The Court also ruled that under precedent in the District of Delaware administrative expense claims are not subject to section 502(d).

Warm Regards,
Roland

News

- ↳ Madoff Trustee Begins Seventh Pro Rata Interim Distribution of Recovered Funds to Madoff Claim Holders
- ↳ Turner Grain’s Bankruptcy Takes Toll on Farmers
- ↳ Chemla, Founder of a Travel Company, ALTOUR Settles Madoff

Distribution of Adversary Proceeding by Bankruptcy Court



Clawback Lawsuit

- ↳ Rothstein Feeder Fund Resolves With Insurers For \$2.2 Million
- ↳ Health Diagnostic Laboratory Initiates Second Round of Clawback Litigation

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- ↳ Settlement Funds Voluntarily Transferred Under the Pretext of Fraudulent Inducement are Property of the Estate
- ↳ A New York Bankruptcy Court Narrows Madoff Trustee's \$905 Million Lawsuit Against an Accounting Firm
- ↳ Imperative to Meet Rule 9019 Standards For Courts to Approve Compromise Between the Parties
- ↳ Second Circuit - Bankruptcy Court Did Not Abuse its Discretion in Excluding the Documentary Evidence While Granting Judgment For Trustee
- ↳ A Trustee is Not Barred to Bring an Action to Recover Fraudulent Transfers Even When Debtor Agreed to Dismiss the Litigation Under a Settlement Agreement
- ↳ Fraudulent Intent and Conduct of a Company's Director May be Imputed to the Company
- ↳ A Debtor's Prepetition Transfer of a Farm was Fraudulent Because No Reasonably Equivalent Value was Received in Exchange
- ↳ Quantum Foods – Preference Liability May be Set-off By an Allowed Post-Petition Administrative Claim

Recent Preference and Fraudulent Conveyance News

Madoff Trustee Begins Seventh Pro Rata Interim Distribution of Recovered Funds to Madoff Claim Holders

New York, July 1, 2016 - Irving H. Picard, Securities Investor Protection Act (SIPA) Trustee for the liquidation of Bernard L. Madoff Investment Securities LLC (BLMIS), commenced the seventh pro rata interim distribution from the customer fund to eligible BLMIS customers on June 30, 2016.

The SIPA Trustee is distributing approximately \$190.247 million on a pro rata

basis to BLMIS account holders with allowed claims, bringing the aggregate amount distributed to eligible claimants to approximately \$9.47 billion, which includes approximately \$836.6 million in committed advances from the Securities Investor Protection Corporation (SIPC). The seventh distribution represents 1.305 percent of each claim dollar and will be paid on claims relating to 972 BLMIS accounts to record holders of allowed claims as of June 15, 2016. When combined with the prior six distributions, in aggregate, at least 58.369 percent of each customer's allowed claim amount will be paid,

unless that claim has been fully satisfied. Currently, the SIPA Trustee has allowed 2,597 claims related to 2,249 BLMIS accounts. Of these, 1,296 accounts will now be fully satisfied following the seventh interim distribution. All allowed claims totaling \$1,200,024.90 or less will be fully satisfied after the distribution.

To date, the SIPA Trustee has recovered or reached agreements to recover approximately \$11.168 billion since his appointment in December 2008.

Turner Grain's Bankruptcy Takes Toll on Farmers

July 3, 2016, Arkansas – Approximately, two years after **Turner Grain, a commodity broker, filed for bankruptcy protection** former customers have started receiving **preference letters** informing them that money they received from the company shortly before the bankruptcy filing may have to be returned. These letters specify that the payments they received within 90-days before the bankruptcy are being reviewed as possibly preferential payments, meaning those funds might have to be paid back. The farmers are perturbed as they cannot pay the amount back because they have probably either lost everything or re-mortgaged everything.

Turner Grain Merchandising, Inc. filed for bankruptcy protection on October 23, 2014. The bankruptcy case is pending before the United States Bankruptcy Court for the Eastern District of Arkansas. The case number for the lead bankruptcy case is 14-15687. The bankruptcy case is currently assigned to United States Bankruptcy Judge Phyllis M. Jones. The law firm of Keech Law Firm, P.A. is acting as lead bankruptcy counsel to Turner Grain

Merchandising, Inc. (d/b/a Turner Grain, Inc.) in the bankruptcy case.

The preference statutes are an attempt to achieve equity between creditors. However, there are defenses against the recovery of a preference payment in 11 U.S.C. 547(c). These include: contemporaneous exchanges; payments made in the ordinary course of the business of the debtor and the creditor on ordinary business terms; and subsequent new value to the debtor. These defenses need to be raised in an answer to a preference complaint. The burden of proof lies with the creditor to establish that despite the elements of a preference; the transfer is protected by one or more of these defenses.

Chemla, Founder of a Travel Company, ALTOUR Settles Madoff Clawback Lawsuit

July 14, 2016, New York – Last month, **Alexandre Chemla, the founder of a private jet service, ALTOUR**, settles a lawsuit brought by the trustee overseeing the liquidation of Bernie Madoff's securities firm. The Madoff trustee sought to recover nearly \$1 million in fictitious profits from the Ponzi scheme. The Trustee had alleged that the transfers received by Chemla constituted non-existent profits supposedly earned in the account. The trustee initiated an adversary proceeding against Lori Chemla and Alexandre Chemla last year in December 2015. However, the parties agreed to settle the litigation pursuant to the court's settlement procedures order and entered into a settlement agreement and release on April 6, 2016. The court has now approved the settlement between the parties and last month the parties stipulated to a dismissal without prejudice of the trustee's claims, subject to the right of the trustee to move ex parte to re-open

the case, in the event of an uncured default under the terms of the settlement agreement.

Rothstein Feeder Fund Resolves With Insurers For \$2.2 Million

Florida, July 27, 2016 – Last week, a Florida bankruptcy court approved a \$2.2 million deal between **Robert C. Furr, the Chapter 7 trustee of Banyon 1030-32, LLC and Banyon Income Fund, L.P.**, who is liquidating an investment fund that fed into jailed attorney Scott Rothstein's \$1.2 billion Ponzi scheme, and two insurers, namely, Federal Insurance Company and St. Paul Fire and Marine Insurance Company.

Health Diagnostic Laboratory Initiates Second Round of Clawback Litigation

July 28, 2016, Virginia – Last month, Health Diagnostic Laboratory, Inc.'s liquidating trustee (HDL) brought avoidance actions against HDL's vendors, suppliers, and other partners to recover payments made during the 90-days before it filed for bankruptcy on June 7, 2015. HDL

initiated approximately 94 adversary complaints during the last month. The top three creditors in the group included : **VWR International, LLC, MedTest DX, Inc., AB Sciex, LLC.** These entities are being sued for recovery of approximately **\$1.2 million** worth of preference and fraudulent transfers.

HDL, a cardiac biomarker laboratory offered various services such as blood and laboratory analysis; advanced testing; management of chronic diseases, like diabetes mellitus, metabolic syndrome, hypertension, heart failure and stroke, cholesterol, stress, fatty liver disease, obesity, and smoking cessation diseases. It also offered clinical health consulting and advisory services etc.

Honorable Judge Kevin R. Huennekens is presiding over HDL's cases. The cases are filed in the United States Bankruptcy Court for Eastern District of Virginia. The law firm of **Wolcott Rivers Gates** is representing the trustee in the HDL's bankruptcy cases.

Recent Preference and Fraudulent Conveyance Opinions

Settlement Funds Voluntarily Transferred Under the Pretext of Fraudulent Inducement are Property of the Estate

In re Dreier LLP, No. 08-15051-SMB, 2016 U.S. Dist. LEXIS 92322 (S.D.N.Y. July 15, 2016)

Debtors Cosmetics Plus Group and its affiliate companies (**CPG**) filed for Chapter 11 protections in the U.S. Bankruptcy Court for the Southern District of New York. CPG retained the Traub Firm as bankruptcy counsel and subsequently employed the law firm Dreier LLP after Paul Traub and Steven Fox became partners at Dreier LLP. CPG initiated an adversary proceeding against its insurer, **AIG**, to recover losses sustained due to the terrorist attacks. The parties agreed to settle and the Bankruptcy Judge Beatty approved the settlement agreement between **AIG** and **CPG**. Pursuant to the settlement agreement, **AIG** issued a check for \$350,000 to **CPG** and the funds were deposited into the Dreier LLP

attorney trust account. Dreier LLP, in turn transferred the funds to the Traub firm's account (the Traub Firm Transfer). After sometime, Drier LLP filed for bankruptcy and the Trustee sought the return of the Traub Firm Transfer which the law firm held subject to further direction from the Court. The Traub Firm wired the amount back to the Trustee's account. CPG filed proofs of claim in the Dreier LLP's case, alleging that they had a secured claim in the proceeds of the settlement agreement.

The bankruptcy court concluded that CPG did not have a secured interest in the settlement proceeds that were paid to the firm because the firm commingled the proceeds with other money it held in a trust account. Further, the transfer of settlement funds from the Drier account to the Traub account created an express trust and this express trust was created only a few days before the commencement of Dreier's Chapter 11 case. Thus, the alleged transfer of funds constituted an avoidable preference pursuant to Sec. 547(b). **The Court reclassified CPG's alleged proofs of claim numbers as general unsecured claims and also ruled that the Traub Firm Transfer was a preference under Sec. 547(b).**

Upon appeal, **CPG alleged that the bankruptcy court erred in finding that the Traub Firm transfer was an avoidable preference as there was a legally enforceable obligation to turn over the settlement agreement funds to CPG** because they had an elevated priority interest in the funds held by Dreier LLP. CPG also alleged that the bankruptcy court erred by failing to impose a constructive trust on the settlement agreement proceeds transferred because the alleged transfer was not part of the Dreier estate and Dreier was required to hold these funds in escrow for CPG. **The Trustee argued that the alleged transfer of funds provided CPG with the rights superior to the general unsecured creditors and hence, the transfer was an avoidable preference pursuant to Sec. 547(b).**

Relying upon the decision of Judge Batts in a separate bankruptcy appeal stemming from the Dreier bankruptcy, **the District Court in the case at bar ruled that the settlement funds that were voluntarily transferred into the Dreier account - albeit under the pretext of a fraudulent inducement, become property of the Dreier estate.** The District Court agreed with the bankruptcy court that the monies constituting the transfer of funds from Dreier to the Traub Firm account were, in fact, property of the Dreier estate and hence avoidable. The District Court also agreed that the Drier account consisted of commingled funds of various Dreier clients and that the Traub transfer was not traceable.

The District Court concurred that CPG was not entitled to a relaxation of the tracing requirement because CPG was unable to demonstrate that the bankruptcy estate would be unjustly enriched in the absence of a constructive trust and the Debtor estate would not retain any of the funds if the constructive trust failed. The Court added that recognition of a constructive trust under these circumstances would merely prejudice other creditors whose assets had also been misused by the Dreier firm. The Court also stated that the Judge Beatty's order did not create anything other than an obligation to transfer general Dreier assets (the settlement proceeds having been dissipated long before). It did not create any security or other interest in the transferred Drier account assets that insulated those funds from the claims of other Dreier creditors in the context of the bankruptcy proceeding. The District Court affirmed the Bankruptcy Court's decision on all aspects and concluded that the alleged transfer was a preference pursuant to Sec. 547 of the Bankruptcy Code.

A New York Bankruptcy Court Narrows Madoff Trustee's \$905 Million Lawsuit Against an Accounting Firm

In re Bernard L. Madoff Inv. Secs. LLC, Nos. 08-01789 (SMB), 10-05421 (SMB), 2016 Bankr. LEXIS 2686 (U.S. Bankr. S.D.N.Y. July 21, 2016)

The lawsuit arose from the massive Ponzi scheme masterminded by **Debtor Bernard L. Madoff and executed through Bernard L. Madoff Investment Securities LLC (BLMIS)**. **Defendants Frank J. Avellino and Michael Bienes** were certified public accountants and partners in an accountant firm **Avellino & Bienes**. Irving H. Picard, the Trustee for the liquidation of the estate of BLMIS and the estate of Bernard L. Madoff, brought a lawsuit against the Defendants to avoid and recover fraudulent transfers **worth \$900 million**, made within two and six years of the petition date pursuant to Sec. 548 of the Bankruptcy Code. The Trustee accused the Defendants of helping conceal Madoff's Ponzi scheme by working hand in hand with Madoff to pool money from the innocent investors, create fake account statements and drive the Ponzi scheme to fill their pockets with millions of dollars.

The Defendants moved to dismiss the complaint, making several arguments relating to the Trustee's standing and the Court's jurisdiction. **The Defendants contended that the complaint failed to adequately allege the Defendants' willful blindness and therefore, the transfers made within two years prior to the petition date were protected by the "good faith" defense under 11 U.S.C. § 548(c)**. The Defendants next contended that any transfers made prior to 2001 were not within the power of the Trustee to avoid, nor within the jurisdiction of the court to adjudicate. The Defendants reasoned that **since Madoff operated his business as a sole proprietorship and BLMIS, a limited liability company, began operations only on January 1, 2001, the Trustee cannot recover transfers made by the sole proprietorship before January 1, 2001**. In response, the Trustee argued that BLMIS' change in form from a sole proprietorship to a limited liability company was irrelevant to the issue of standing as the substantive consolidation of the Madoff and BLMIS estates authorized the Trustee to avoid and recover transfers by the sole proprietorship as well as the BLMIS.

On the Defendants' first argument, the Court stated that in order to meet his pleading burden, the Trustee must plead that the Defendants had actual knowledge that BLMIS was not engaged in the trading of securities or that the Defendants willfully blinded itself to the fact that BLMIS was not engaged in the actual trading of securities. The Court found that in the case at bar - **although the Defendants initially disputed the allegations of willful blindness, the attorney of the Defendants conceded at oral argument that the Trustee had adequately alleged the Defendants' willful blindness under the standard applied by the Court**. Accordingly, the Court ruled that as the statements made by an attorney during oral argument constitute binding judicial admissions, the Trustee's complaint adequately plead facts implying that the Sec. 548(c) defense was not available to the Defendants even if they did give value.

On the Defendants' second argument the Court ruled that the distinction of sole proprietorship and company was an important one. The customer property invested with BLMIS never became property of Madoff or BLMIS under applicable non-bankruptcy law, and an ordinary bankruptcy trustee cannot

recover it. Though, the Trustee can recover the transfers of customer property by BLMIS, he cannot recover the transfers of customer property made by Madoff individually. Further, the substantive consolidation of the BLMIS and Madoff estates did not empower Madoff's Chapter 7 Trustee to exercise the powers of a BLMIS trustee. **Thus, the Trustee in the case at bar lacked power to recover transfers made before Jan. 1, 2001.**

Imperative to Meet Rule 9019 Standards For Courts to Approve Compromise Between the Parties

In re Stanfill, No. 3:15-bk-30233-SHB, 2016 Bankr. LEXIS 2535 (U.S. Bankr. E.D. Tenn. July 8, 2016)

Debtor Jacqueline Stanfill was an investment advisor who induced her clients to fund what they believed were legitimate investments with a brokerage firm when in fact, the Debtor either lost the invested funds in other ventures personal to her or spent the funds on herself and her family and friends as part of a lavish lifestyle. The Debtor pleaded guilty to federal charges and was sentenced imprisonment. Later, an involuntary petition was filed against the Debtor and the Trustee discovered that there was a fraudulent transfer of assets from the Debtor to Regina Lambert, (Debtor's spouse) that was liable to be avoided for the benefit of the bankruptcy estate. Subsequently, **the Trustee and Lambert's attorney negotiated and agreed to settle the Trustee's potential fraudulent conveyance claims. After arriving at settlement, the Trustee filed a motion to compromise with the bankruptcy court and the creditors of the Debtor objected to the motion.**

The issue before the Court was whether a compromise or settlement was fair and should be approved despite the objections of other creditors. The Court stated that its authority to approve or disapprove the compromise motion arises from Rule 9019 of the Federal Rules of Bankruptcy Procedure. As a general rule, settlements and compromises are favored in bankruptcy as they minimize costly litigation and further parties' interests in expediting the administration of the bankruptcy estate. At the same time, however, it is essential that every important determination in bankruptcy proceedings receive the 'informed, independent judgment of the bankruptcy court. **The Court elaborated that it is not permitted to act as a mere rubber stamp or to rely on the trustee's word that the compromise is reasonable. Rather, the court possesses an affirmative obligation to appraise itself of the underlying facts and make an independent judgment as to whether the compromise is fair and equitable.**

After weighing all factors, the Court concluded that the proposed settlement between the Debtor's estate and the Debtor's spouse was not approved because the Trustee failed to meet his burden under FRBP 9019 to show that the proposed settlement was fair and equitable and in the best interest of the estate. The Court reasoned that **the Trustee's evidence failed to show that it would be cost prohibitive to file an adversary proceeding to seek recovery of fraudulent conveyances under Sec. 548 and/or state law, or that the adversary proceeding would be unnecessarily complex.** The Court also found that it was not clear that there was a lesser probability of success, if an adversary proceeding were to be filed because there were still a great number of records that had not yet even been examined.

Accordingly, the Court denied the Trustee's motion to compromise between the parties as the Trustee failed to meet his burden under Rule 9019 and the proposed settlement did not weigh more favorably for the benefit of the estate.

Second Circuit - Bankruptcy Court Did Not Abuse its Discretion in Excluding the Documentary Evidence While Granting Judgment For Trustee

John Nagle Co. v. McCarthy (In re Cousins Fish Mkt., Inc.), No. 15-3710-bk, 2016 U.S. App. LEXIS 12753 (2d Cir. July 12, 2016)

Debtor Cousins Fish Mkt., Inc was a retail seller of fish and seafood in New York. **Defendant John Nagle Co.** was a fish and seafood wholesaler located in Massachusetts. Nagle supplied Cousins with fish and seafood. During the course of business, Cousins made transfers worth \$108k to Nagle allegedly during the 90-day period prior to the bankruptcy and the Trustee of Cousin's bankruptcy estate sought to avoid these transfers as preferences. The bankruptcy court entered judgment against Nagle and in favor of the Trustee after ruling that the alleged transfers were avoidable preferences under Sec. 547(b). The District Court affirmed. Nagle appealed.

On appeal, Nagle alleged that the bankruptcy court erred by excluding certain documentary evidence and witness testimony from the bench trial and also erred in concluding that Nagle failed to prove its affirmative defenses under Sections 547(c) (1) and (c) (2).

The Second Circuit rejected Nagle's appeal as meritless and found that after conducting a hearing on the Trustee's motion in limine, the bankruptcy court did articulate the factors from *Patterson v. Balsamico*, 440 F.3d 104, 117 (2d Cir. 2006), and considered each seriatim. Thus, the bankruptcy court's findings were not erroneous. The Court agreed with the lower courts that - Nagle failed to meaningfully explain why the evidence was not produced or disclosed during discovery; that prejudice to the Trustee would be great given that discovery had been closed for more than three months despite previous extensions; and that a continuance would be inopportune because the bench trial was scheduled to commence in only two weeks and pretrial statements were due in less than one week. **Hence, the Second Circuit held that based on the facts and circumstances, it cannot rule that the bankruptcy court abused its discretion in excluding the documentary evidence and related witness testimony.**

Next, since Nagle did not introduce any testimony or contractual terms governing the transfers, the Second Circuit agreed with the bankruptcy court's holding that Nagle failed to prove the requisite intent under Sec. 547(c)(1) with respect to the contemporaneous exchange for new value defense. The Second Circuit also found that Nagle failed to prove a sufficient baseline of prior dealings between the parties and there was a lack of evidence of when payments were due during the pre-preference period or of an agreement between the parties that showed the terms of the transfers. Thus, **the Court held that the ordinary course defense under Sec. 547 (c) was also unavailable to Nagle.**

The Second Circuit affirmed the judgment of the bankruptcy court and ruled in favor of the Trustee.

A Trustee is Not Barred to Bring an Action to Recover Fraudulent Transfers Even When Debtor Agreed to Dismiss the Litigation Under a Settlement Agreement.

DeGiacomo v. Tobins (In re Upper Crust, LLC), Nos. 12-18134-JNF, 14-1163, 2016 Bankr. LEXIS 2656 (U.S. Bankr. D. Mass. July 20, 2016)

In 2005, **Tobin, Huggard and Higgins formed Upper Crust, LLC (Debtor)**, a chain of pizza restaurants that provided customers with traditional and innovative pizza combinations. Beginning in or around the end of 2007, **Tobin (Defendant) allegedly transferred funds belonging to Upper Crust to himself to pay for his personal expenses** and to support his extravagant lifestyle with his then girlfriend and alleged employee of the Debtor, Stefany. **Stefany later married Tobin and was also a Defendant in this action.** Huggard and Higgins, after allegedly discovering that Tobins diverted funds from Upper Crust, filed an action against Tobins to recover those funds. **After the commencement of the litigation, the parties engaged in settlement discussions and finally executed a settlement agreement, under which Upper Crust agreed to dismiss the litigation in exchange for a payment of \$250,000.** Further, **Upper Crust agreed to release the Tobins of any liability for past expenses, salaries, distributions and agreed not to file charge or sue the Tobins.** Tobins honored the settlement agreement and paid \$250,000 to Upper Crust. However, no court approval was obtained and Upper Crust also failed to file stipulation of dismissal to this effect in the court. Subsequently, Upper Crust filed for bankruptcy and the Trustee for Upper Crust's bankruptcy estate brought adversary proceeding against Tobins to recover funds which Tobins fraudulently diverted for their own use pursuant to Sec. 548 of the Bankruptcy Code.

Tobins argued that the Trustee lacked standing to assert any claims for fraudulent conveyance because the claims were not property of the estate and not subject to avoidance under Sec. 548. **Tobins reasoned that the Upper Crust waived and released all claims against them under a settlement agreement, including the right to seek the return of the funds allegedly diverted, in exchange for payment of \$250,000 before it filed for bankruptcy. The Trustee countered that the settlement agreement was not enforceable and was invalid due to the failure to obtain necessary court approvals and was never consummated due to the parties' failure to satisfy material conditions precedent.**

The Court agreed with the Trustee and concluded that the Trustee was not bound by the settlement agreement. **The Court elaborated that even assuming that the settlement agreement and the concomitant release of the defendants was enforceable among the parties executing it and binding upon Huggard, Higgins, Upper Crust, but the creditors of the Debtor, in whose shoes the Trustee stands, cannot be included among that group.** The Court ruled that the Trustee's claims were independent of, and separate from, pre-petition causes of action, which the Debtor possessed outside of bankruptcy. Further, **the Trustee's claims against the Tobins under Sec. 548 and state law belonged to the Debtor's creditors and were transferred to the Trustee with the Debtor's slide into bankruptcy.** The Court ruled in favor of the Trustee and held that the Trustee did not lack standing in the case to bring an action to recover fraudulent conveyance pursuant to Sec. 548.

Fraudulent Intent and Conduct of A Company's Director May be Imputed to the Company

In re Lyondell Chem. Co., No. 16cv518 (DLC), 2016 U.S. Dist. LEXIS 98057 (S.D.N.Y. July 27, 2016)

Debtor Lyondell Chemical Co. (Lyondell) was a large publicly-traded petrochemicals company based in the United States. Lyondell was the target of a leveraged buyout by an activist investor, Leonard Blavatnik for quite some time and finally in 2007 Blavatnik purchased Lyondell in a leveraged buyout (LBO). The LBO was 100% financed by debt secured entirely by Lyondell. Lyondell took on approximately \$21 billion of secured indebtedness in the LBO provided by the lending banks, of which \$12.5 billion was paid out to Lyondell shareholders, officers and directors. As a result of the LBO, Lyondell merged with a Blavatnik-controlled company, an affiliate of Basell AF SCA, creating a merged entity known as LyondellBasell Industries AF SCA (LBI). Within 13 months of the merger closing, Lyondell and its affiliates filed for bankruptcy. LBI also filed for bankruptcy protection thereafter. In early 2010, the bankruptcy court approved Lyondell's plan of reorganization, which established the LB Litigation Trust and Edward Weisfelner was appointed the Trustee of the trust.

The Trustee alleged that Dan Smith, Lyondell's CEO and chairman of the Lyondell board of directors allegedly presented false financial projections to the Lyondell board when it was considering the LBO and hence transfers worth \$6.3 billion in distributions made to Lyondell shareholders through the LBO were intentional fraudulent transfers pursuant to Sec. 548 of the Bankruptcy Code. The Trustee further alleged that the Lyondell's board of directors knew the projections prepared at Smith's request were inflated, unreasonable, and unachievable and should have limited the company's leverage. Still, they unanimously approved the merger and as a result, the debt undertaken by Lyondell resulting from the false projections left it undercapitalized and put creditors at significant risk. Thus, **the Trustee argued that Lyondell's transactions amounted to an actual fraudulent transfer under Section 548 of the Bankruptcy Code based on the imputed intent of Smith, who requested and manufactured false and misleading projections to defraud Lyondell's creditors by stripping the company of assets to enrich himself and other Lyondell shareholders.**

The Bankruptcy Court rejected the Trustee's intentional fraudulent transfer claim under Sec. 548 (a) (1) (a) and held that Smith's intent could not be imputed to Lyondell. The Court reasoned that since Delaware law requires that a corporation's board of directors approve any merger or LBO, **it was the intent of Lyondell's Board and not of Smith that was critical to determine actual intent to defraud under Sec. 548.** Smith's intent may be imputed to Lyondell only if Smith was in a position to control the Board's decision to proceed with the LBO. Since, there was no proof that Smith controlled his board on the LBO vote, or that a critical mass of directors intended to defraud creditors, Smith's intent could not be imputed to the board. The bankruptcy court also held that the Trustee failed to plead facts supporting intent to hinder, delay or defraud on the part of a critical mass of the directors who approved the LBO or by Smith.

The Trustee appealed that the Bankruptcy Court erred by (1) ruling that the knowledge, conduct and intent of Lyondell's CEO and Chairman and other members of Lyondell management in connection with the payments may not be imputed to Lyondell (2) ruling that the Trustee did not adequately allege that Lyondell incurred debt and transferred the shareholder payments with actual intent to hinder, delay or defraud its creditors.

Upon appeal, **the District Court reversed the bankruptcy court's decision** and held that the Trustee's actual fraudulent transfer claims against Lyondell's shareholders can proceed on the basis that the alleged fraudulent intent of Lyondell's former chairman and CEO could be imputed to the company.

On the first argument, the District Court held that the bankruptcy court's conclusion was incorrect. The Court concluded that the requirement that the Trustee demonstrate Smith's control over the Lyondell Board does not have any basis in Delaware law. **Neither the Bankruptcy Court nor the shareholders cited any authority for the proposition that a corporate officer's knowledge and intent may not be imputed to the corporation when the corporation's board votes on the decision at issue.** The Court ruled that there was no basis to infer, based on the fact that the LBO required the approval of the Board, that long established agency law principles should be altered. **The Court stated that it is state law which supplies the governing law principles for assessing the imputation of a corporate officer's intent to a corporation for purposes of Sec. 548.** Since, Lyondell was a Delaware corporation and engaged in the merger pursuant to the Delaware law, **the Delaware's law of imputation governed and the Delaware courts adhere to the "general rule of imputation" and hold a corporation liable for the acts and knowledge of its agents" even when the agent acts fraudulently or causes injury to third persons through illegal conduct.** Thus, the Court held that Smith's knowledge and intent may be imputed to Lyondell. So, when Lyondell conveyed the shareholder payments, it did so with intent to defraud Lyondell creditors pursuant to Sec. 548 of the Bankruptcy Code.

On the second argument, the District Court ruled that the since the Bankruptcy Court failed to impute Smith's knowledge and intent to Lyondell, it did not complete the appropriate analysis and determined whether a claim of intentional fraudulent inducement was adequately pled once Smith's knowledge and intent were imputed to the corporation. **The District Court concluded that the Trustee adequately pleaded a claim that Lyondell engaged in an intentional fraudulent transfer of its assets through the LBO.** The Court found that as the majority of Lyondell's assets were subject to liens after the LBO, the LBO had the effect of essentially stripping Lyondell of its assets. **Smith knew that Lyondell was underperforming its projections and that Lyondell's debt burden would deprive it of the flexibility it needed to face the challenging business and financial conditions it was experiencing.** Accordingly, the Court concluded that the Trustee also pleaded sufficient facts from which it could properly be inferred that Smith not only recklessly disregarded the likelihood that the LBO would quite quickly injure creditors, but also contemplated and believed that Lyondell would default on its obligations to its creditors within a very short period of time. The Court further found that indeed, that was precisely what happened. Lyondell filed for bankruptcy roughly a year after the LBO.

The Court thus, concluded that the Trustee pleaded facts sufficient to create a strong inference that Smith acted with actual intent to hinder, delay and defraud Lyondell's creditors. Accordingly, the

District Court reversed the Bankruptcy Court's decision and the Trustee's intentional fraudulent conveyance claim was reinstated.

A Debtor's Prepetition Transfer of a Farm was Fraudulent Because No Reasonably Equivalent Value was Received in Return

Zeddun v. Griswold (In re Wierzbicki), No. 16-1334, 2016 U.S. App. LEXIS 13688 (7th Cir. July 27, 2016)

Debtor Laura Wierzbicki owned a 40-acre farm in Wisconsin, where she lived for a time with her three minor children and their father, **Defendant Greg Griswold**. Wierzbicki and Griswold lived and worked together on the farm, where they also operated a business salvaging boats. Sometime before 2009, their personal and business relationships soured and Griswold sued Wierzbicki in state court for unjust enrichment and collateral estoppel. Wierzbicki apparently wanted an end to the litigation and she accepted Griswold's promise to drop the rest of the litigation if she gave up the farm. They arrived at an agreement wherein, Wierzbicki gave Griswold a quitclaim deed to the farm and in exchange received Griswold's promise to abandon the litigation and to assume about \$149,000 in liabilities secured by the property.

Fourteen months later, Wierzbicki filed for Chapter 7 bankruptcy and the Trustee brought an adversary proceeding in bankruptcy court against Griswold to avoid the alleged transfer of farm as fraudulent. **The Trustee asserted that the transfer of the farm was constructively fraudulent and thus avoidable because Wierzbicki was insolvent at the time of the transfer and that she had not received reasonably equivalent value in exchange for the property. Griswold argued that his promises to Wierzbicki provided reasonably equivalent value and that the farm's value to Wierzbicki at the time of the transfer was essentially nothing because of various encumbrances.**

After a trial, the **Bankruptcy Judge Martin avoided the transfer**, concluding that Griswold had exchanged nothing of value for the farm. The District Court affirmed. On appeal, Griswold argued that the Bankruptcy Court overvalued Wierzbicki's interest in the property at the time of the transfer by not taking into account a *lis pendens* that he had filed in relation to the property. He also alleged that he provided reasonable equivalent value and the alleged transfer was not fraudulent pursuant to Sec. 548 of the bankruptcy code.

The Seventh Circuit opined that in determining whether a debtor received reasonably equivalent value, courts consider all the circumstances of the transfer, including the fair market value of what was transferred and received, whether the transaction took place at arm's length, and the good faith of the transferee. **In the case at bar, the transaction between Wierzbicki and Griswold was not at arm's length, and Wierzbicki's testimony that the main reason she agreed to give Griswold the farm was to stop the frivolous litigation which suggested that Griswold was not negotiating in good faith.** The Court also rejected Griswold's *lis pendens* argument because under Wisconsin law, a *lis*

pendens simply alerts third parties to judicial proceedings involving real estate and does not create an encumbrance on the property.

Finally, the Court affirmed the bankruptcy court's judgment and held that **since Wierzbicki gave up a \$300,000 farm in which she had \$151,000 equity in exchange for very little value, the bankruptcy court's finding that Wierzbicki did not receive reasonably equivalent value was correct and certainly was not clearly erroneous** and the Debtor's alleged prepetition transfer of a farm to the defendant was a fraudulent transfer subject to avoidance.

Quantum Foods – Preference Liability May be Set-off by an Allowed Unpaid Post-Petition Administrative Claims

Official Comm. of Unsecured Creditors of Quantum Foods, LLC v. Tyson Foods, Inc. (In re Quantum Foods, LLC), No. 14-10318, 2016 Bankr. LEXIS 2785 (U.S. Bankr. D. Del. July 25, 2016)

Debtor Quantum Foods, LLC manufactured and distributed protein products such as beef, pork, and poultry, custom ready to cook products etc. and custom menu solutions. **Defendant Tyson Foods, Inc.** is the processor and marketer of chicken, meat, beef, and pork. Defendant supplied meat products to the Debtor. The Debtor filed for voluntary Chapter 11 bankruptcy petition. Tyson had almost \$14 million in preference exposure. Tyson supplied additional meat products to the Debtor post-petition as well and filed a motion for allowance of an administrative expense claim seeking payment for the post-petition deliveries. The Court allowed Tyson's administrative expense claim pursuant to Sec. 503(b) (1) (A) in the amount of \$2,603,841.09.

The creditors committee brought an adversary proceedings against Tyson to avoid preferential transfers under Sec. 547 and to recover those transfers under Sec. 550. Tyson claimed for the right to offset the unpaid administrative claim against preference liability. **Tyson denied that the Debtor's transfers to Tyson constituted avoidable preferences and sought a declaratory judgment that disallowance under Sec. 502(d) applied only to pre-petition claims and they do not interfere with the allowed post-petition administrative claim.** Tyson asserted that its claim was an extrinsic setoff claim, wholly unrelated to the concept of new value defense or to the Sec. 547 preference analysis generally. **The Committee argued that Tyson's setoff claim was really a disguised or renamed post-petition new value defense because like a new value defense, it had the effect of reducing the total amount of preferential transfers restored to the estate.** The Committee also argued that Sec. 502(d) prohibits set off of Tyson's administrative claim until the preference is paid in full.

The issue before the court was: **Whether an allowed, but unpaid post-petition administrative expense claim can be used to set off preference liabilities?**

Citing the Third Circuit's Friedman's decision, the bankruptcy court first stated that the preference analysis cannot be affected by post-petition activity. The Court said that it doesn't make sense to refer to any claim arising outside of the preference period as a new value defense. The Court added that a new

value defense necessarily involves pre-petition activity, so association of the term "post-petition" and the term "new value defense" was inappropriate. Tyson's claim comprised exclusively of post-petition activity and a Sec.547(c) (4) new value defense is limited to pre-petition activity. The Court also rejected the committee's argument that Tyson's claim was a disguised new value defense. The Court reasoned that the Tyson's setoff claim did not affect the bottom line of the preference calculation; rather, setting off Tyson's administrative claim affected only the amount paid to the estate. Thus, the Court held that the **post-petition goods and services may not be counted as subsequent new value under section 547(c)(4) of the Bankruptcy Code.**

On the issue of setting off a post-petition administrative claim, the Court pointed out that as per the judicial consensus; "setoff is only available in bankruptcy when the opposing obligations arise on the same side of the . . . bankruptcy petition date" i.e. the setoff applies to mutual, post-petition obligations. The Court stated that the Tyson's administrative claim was clearly a post-petition obligation of the Debtor and the setoff was permissible in this case only if the allegedly opposing obligation - the preference claim - also arose post-petition. The Court added that as a matter of fact, a preference action is initiated only after the filing of a bankruptcy case or post-petition and preferential transfer claims are post-petition causes of action. Accordingly, **Tyson correctly characterized its claim as a setoff claim, rather than as a post-petition new value defense. Thus, the Court concluded that the Tyson's right to set off its allowed administrative expense claim against its preference liability was permissible.**

The Court next rejected the Defendant's assertion that pursuant to Section 502(d), Tyson was not entitled to any payment, including administrative payments, until the preference payment was satisfied. The Court reasoned that while section 502(d) requires courts to disallow claims of preference recipients and recipients of other transfers avoidable under Chapter 5 of the Bankruptcy Code until all liability has been paid to an estate, the Court disagreed that it could be used to prevent Tyson's administrative claim setoff, simply because, under precedent in the District of Delaware, "administrative expense claims...are not subject to section 502(d) and are accorded special treatment under the Bankruptcy Code".

The Court ruled in favor of Tyson and broadly concluded that the unpaid post-petition administrative claims, meeting the requirements for setoff under the applicable state laws, may be utilized to set off against preference liability.

Snapshot of Clawback Cases Filed

Adversary Proceedings filed by the Debtors	Total cases filed	Name of Judge	Largest Case in the group	Claim Amount of the Largest Case	Petition Date	District
Gravity-Ratterman, LLC	22	Joan A. Lloyd	Sunbelt Rentals, Inc.	\$153,684.25	7/21/2014	Western District of Kentucky

Gulf Packaging, Inc.	48	Pamela S. Hollis	Acme Packaging Corporation	\$2,061,780.84	4/29/2015	Northern District of Illinois
Health Diagnostic Laboratory, Inc.	94	Kevin R. Huenneken s	VWR International, LLC	\$758,587.77	6/7/2015	Eastern District of Virginia
The Truland Group, Inc.	88	Brian F. Kenney	Local 26, IBEW - NECA Joint Trust Funds	\$2,713,864.40	7/23/2014	Eastern District of Virginia

BIO

About Roland Jones



Mr. Jones has practiced bankruptcy law for over two decades. His primary focus is representing corporate defendants in preference and fraudulent conveyance litigation. Mr. Jones has a national client base and has also represented corporate clients based in Europe and the Far East.

In addition to his law practice, Mr. Jones has authored professional articles on bankruptcy issues for the *New York Law Journal*, *The Environmental Claims Journal*, *The Mergers and Acquisitions Report*, and other scholarly publications.

Mr. Jones also edits and writes the *Clawback Report*, a monthly publication on preference and fraudulent conveyance litigation.

Mr. Jones was the founding member and former Chair of the Federal Bar Association Empire State Chapter Bankruptcy Committee. The Bankruptcy Committee has hosted experts to speak on topics important to both bankruptcy and non-bankruptcy practitioners. Guest speakers have included The Honorable Jerrold Nadler on new bankruptcy legislation, Wilbur L. Ross, Jr. of Rothschild Inc. on the distressed bond market, and Professor Edward Altman of New York University on bankruptcy investing.

Mr. Jones is the founding member and current President of the National Association of Bankruptcy Litigators. The NABL is a new organization focusing exclusively on clawback issues consisting of 110 bankruptcy lawyers from throughout the country.

Mr. Jones' introduction to bankruptcy practice began by serving as a judicial law clerk to Chief U.S. Bankruptcy Judge Conrad B. Duberstein of the Eastern District of New York during law school. He continued his training after graduation by clerking for U.S. Bankruptcy Judge Cecilia H. Goetz of the Eastern District of New York from 1990 to 1991.

Mr. Jones attended the Horace Mann School, Columbia University (B.A. Ancient Studies) and Brooklyn Law School (J.D. 1990) He is admitted to practice law before the United States District Courts for the Southern and Eastern Districts of New York, as well as the United States Court of Appeals for the Second Circuit.

Mr. Jones was born in New York City.

Bar Admissions

New York State Bar Admission - 1990

United States District Court Southern District of New York - 1991
United States District Court Eastern District of New York - 1991

Professional Memberships

President: National Association of Bankruptcy Litigators
Member: New York State Bar Association
Member: Association of Bar City of New York
Member: Turnaround Management Association
Member: American Bankruptcy Institute

Education

1972 – 1977: The Horace Mann School
1977 – 1979: Vassar College
1985 – 1987: Columbia University; top 10% of the graduating class
1988 – 1990: Brooklyn Law School; top 10% of the graduating class

Writings

“Are repos exempt from automatic stay?”; Bankruptcy Law - New York Law Journal; Pg. 31, (col. 6); Vol. 213, 2586 words

“Bankruptcy’s conflict of Interest Rule”; Outside Counsel - New York Law Journal; Pg. 35, (col. 3); Vol. 212, 2117 words

“Bankruptcy and Environmental Law”, The Environmental Claims Journal

“Mergers and Acquisitions in Bankruptcy”, The Mergers and Acquisitions Report

The Clawback Report, A Quarterly Publication on Preference and Fraudulent Conveyance Litigation Issues.

“Introduction to Preference Law”, National Association of Bankruptcy Litigators Journal

Bankruptcy Bulletin: “Wellness International Network, Ltd. v. Sharif, 135 S. Ct. 1932 (2015)”, National Association of Bankruptcy Litigators Journal

Majority Report: “Redefining the Circuit Split Over the § 547(c)(4) Subsequent New Value Defense” by Roland Jones, Esq. and Solomon Rotstein, National Association of Bankruptcy Litigators Journal

Videos

Please feel free to watch our video, [Basic Preference Law](#), on YouTube.

Below is a list of other clawback related videos that we have uploaded to YouTube. For an in-depth review of the preference laws, please see our five-part video series. CLE credit is currently available for New Jersey and Texas. We are expecting to be approved in more states shortly.

[Introduction to the Bankruptcy Preference Laws - Part 1/5](#)

[Introduction to the Bankruptcy Preference Laws - Part 2/5](#)

[Introduction to the Bankruptcy Preference Laws - Part 3/5](#)

[Introduction to the Bankruptcy Preference Laws - Part 4/5](#)

[Introduction to the Bankruptcy Preference Laws - Part 5/5](#)

For other videos on special topics regarding clawback law, please see the following:

[Adversary Complaint – Who Bears the Burden of Proof of Service of Process?](#)

[Can Summary Judgment Be Granted If Factual Issues Exist?](#)

[Agriculture Preference Issues - Part 1](#)

[Agriculture Preference Issues - Part 2](#)

[Transfer of a Security Interest in Property During the Preference Period–Is it Preferential?](#)

[Preference Issues in the Construction Industry](#)

[Non-Filing of the Creditor’s Claim Against the Debtor – How Does It Affect Court’s Jurisdiction?](#)

[Sudden Change In the Mode of Payment During the Preference Period-Is It Out of the Ordinary Course?](#)

[Is an Express Trust Constituted During the Preference Period Preferential?](#)

[The Preference Period Payments Match the Base Period Timing of Payments - Are they Preferential?](#)

[Payments Received By a Conduit During the Preference Period - Are they Preferential?](#)

[Change in the Scope of Work- Does the Industry Standard Defense Still Apply?](#)

[Internal E-mail Listing the Assets and Liabilities - Is It Sufficient To Prove Debtor's Insolvency?](#)

[Creation of a Judgment Lien - Is It a Preferential Transfer?](#)

[The Source of Preferential Payments - Is It Relevant To the Preference Analysis?](#)

[What Is the Purpose Behind the New Value Exception?](#)

[Baseline of Dealings For the Ordinary Course Defense - Who Bears the Burden To Establish It?](#)

Faster Payments During the Preference Period - Can They Be Protected By the Ordinary Course Defense?

Payments Resulting From Collection Pressure - Are They Preferential?

Unusually Large Payments During the Preference Period - Can They Be In the Ordinary Course?

Supplying the Products After Receipt of the Alleged Preferential Transfers - Is it New Value?

Payments Resulting From the Deals Deviating From the Normal Scope of Work - Are They Preferential?

Are the Debts Resulting From Agreements Changing the Scope of Business in the Ordinary Course?

Can a Payment Incurred Through Fraud Be In the Ordinary Course of Business?

Transfers Made From Proceeds of Creditor's Collateral - Are They Preferential?

What Are Preference Laws and Why They Should Be Amended?