The ClawBack Report

A Preference and Fraudulent Conveyance Newsletter

Volume 4 Edition 2

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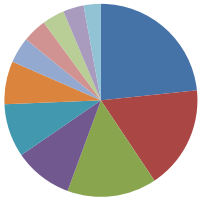
Adversary Proceedings Grouped by Debtor



- Shasa USA LLC
- SkyMall, LLC
- C. Wonder LLC
- S&S Steel Services, Inc.
- Crescent & Sprague Supply Co., Inc.
- Enrizon Worldwide, Inc.
- Neighborhood Health Services Corporation
- WBH Energy, LP and WBH Energy GP, LLC
- Health Diagnostic Laboratory, Inc.
- VPH Pharmacy, Inc.
- ITS Engineered Systems, Inc. and Official Committee of Unsecured Creditors of ITSE

INTRODUCTION

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

Trustees initiated more than **300** adversary proceedings nationwide during the month of January 2017. Most notable -

- **81** clawback lawsuits commenced in the bankruptcy cases of Shasa USA LLC

Ruling for January –

- A New Jersey bankruptcy court denied a debtor's motion for summary judgment because factual records were not sufficient enough to determine ordinary business terms defense under §547(c)(2)(B). The debtor argued that the mere fact that the parties' credit relationship changed during the preference period was sufficient to preclude a finding that the challenged transfers were made according to the ordinary business terms. Rejecting this argument, the court ruled that the relevant inquiry is whether transactions reflect divergence from the industry norms or not.

Warm Regards,
Roland

News

- Merit Management Group Knocks the Doors of the Supreme Court in $16.5M Centaur Ch. 11 Clawback
- Stanford Ponzi Receiver Suffers Jolt on his $88M Clawback Claim Against a Billionaire Investor
- A New York Bankruptcy Court Rejects Merkin's Attempt to Avoid Trial in the Madoff Clawback Action

Opinions

- Avoidance Provisions of the Bankruptcy Code under §547(b) Does Not Apply Extraterritorially
- New Jersey Court – Relevant Inquiry for Determining Ordinary Course Analysis is Whether Transactions Reflect Divergence from Industry Norms

- Trustee Avoids the Transfer as Preference Because the Debtor was Insolvent at the Time the Alleged Transfers Were Made
- Trustee Fails to Demonstrate that a Genuine Issue of Material Fact Exists as to the Debtor's Solvency
- New York Court Grants Defendants' Motions to Dismiss Because Trustee Failed to Sufficiently Allege that the Debtor Entered the LBO with Actual Intent to Hinder, Delay, or Defraud its Creditors

Recent Preference and Fraudulent Conveyance News

Merit Management Group Knocks the Doors of the Supreme Court in $16.5M Centaur Ch. 11 Clawback

January 5, 2017, New York – **Merit Management Group, LLC**, a former shareholder of a racetrack and casino operator, **Centaur LLC**, recently petitioned the **U.S. Supreme Court** to hear its appeal. Last year, the Seventh Circuit held that §546(e) safe harbor does not protect transfers that are conducted through financial institutions (or the other entities mentioned under §546(e)), where the entity is neither a debtor nor a transferee but only the conduit. Merit alleged that the Seventh Circuit misinterpreted the section of the bankruptcy code that protects certain prepetition payouts "by or to" financial institutions from clawback. Merit asserted that the Seventh Circuit decision is wrong in at least three respects as - it disregards the plain language of the statute; it mistakes breadth for ambiguity; it substitutes the court's understanding of Congress' principal goals for language that Congress chose to implement its objective.

Earlier, Merit had sought review by filing a petition for rehearing en banc, but the Court denied Merit's petition for rehearing. The current underlying case is *Merit Management Group LP v. FTI Consulting Inc*., case number 16-784, in Supreme Court of the United States.

Stanford Ponzi Receiver Suffers Jolt on his $88M Clawback Claim Against a Billionaire Investor

January 17, 2017, Texas – Last year, **Ralph Janvey,** the receiver for a $7 billion Ponzi scheme run by **R. Allen Stanford**, requested a Texas federal jury to allow him to recoup nearly $88 million from a billionaire investor and a film producer Gary D. Magness. The Receiver alleged that **Gary Magness** knew or should have known that **Stanford International Bank Ltd**. was insolvent and still engaged in the fraudulent activity at the time his investment vehicles—GMAG LLC, Magness Securities LLC, and Mango Five Family Inc. took out $88.2 million in loans from the bank. Magness countered that he had no reason to believe that the Stanford bank was a multibillion-dollar fraud. During the recession, plenty of banks were struggling or ended up closing their doors, and they did not turn out to be fraudulent.

The Texas federal jury unanimously found that Gary Magness acted in good faith and need not return the alleged payment. The jury reasoned that although investment vehicles owned by Magness had notice of the Stanford Empire's potential fraud, it would have been futile for Magness to attempt to investigate the Stanford bank's complex fraud because a diligent inquiry would not have revealed to a reasonable

person that Stanford was running a Ponzi scheme. **There appears to be a likelihood of scrutiny of the matter by the Fifth Circuit, as the Receiver possibly may appeal to the Fifth Circuit concerning the issue.** Ralph Janvey is represented by David Arlington, Stephanie Cagniart, Ashley Carr, Brendan Day, Tim Durst, Robert Howell, Scott Powers and Kevin Sadler of Baker Botts LLP and Ben Krage of Krage & Janvey LLP. The Magness parties are represented by Mark J. Barrera and M. David Bryant Jr. of Dykema Cox Smith and Rachel Mentz and Andrew Petrie of Ballard Spahr LLP. The case is *Janvey v. GMAG LLC et al*., case number 3:15-cv-00401, in the U.S. District Court for the Northern District of Texas.

A New York Court Rejects Merkin's Attempt to Avoid Trial in the Madoff Clawback

January 30, 2017, New York – **In a clawback war between Madoff Trustee, Irving Picard and a financier, J Ezra Merkin, the Court sided with Picard, holding that Merkin was willfully blind to Bernie Madoff's Ponzi scheme.** Picard, the trustee for the liquidation of Bernard L. Madoff Investment Securities (BLMIS) LLC, sued Merkin and related entities to recover preferential and fraudulent transfers from BLMIS. Merkin sought summary judgment, alleging that he would not have lost $110 million in the scam had he suspected that Madoff was running a Ponzi scheme. Merkin argued that he was duped by the fraudster like numerous other investors.

Rejecting Merkin's motion, the Bankruptcy Judge Stuart M. Bernstein stated that the evidence presented by Picard was sufficient enough to prove that Merkin was warned as early as 1992 about the possibility of BLMIS being a Ponzi scheme and that the investment returns were too good to be true. The Court concluded that despite the knowledge that Madoff was likely operating a fraudulent enterprise, Merkin did nothing to allay his suspicions. Accordingly, the Court rejected Merkin's attempt to **avoid the trial in the clawback suit involving hundreds of millions of dollars tied to investments in the Bernie Madoff's Ponzi scheme.** The case is *Picard v. Merkin et al.*, case number 1:08-ap-01789, in the U.S. Bankruptcy Court for the Southern District of New York.

Recent Preference and Fraudulent Conveyance Opinions

Avoidance Provisions of the Bankruptcy Code under §547(b) Does Not Apply Extraterritorially

Spizz v. Goldfarb Seligman & Co. (In re Ampal-Am. Isr. Corp.), 562 B.R. 601 (Bankr. S.D.N.Y. 2017)

Debtor Ampal-American Israel Corp worked out of offices located in Herzliya, Israel, where its books and records were also maintained. **Defendant Goldfarb Seligman & Co** is a law firm organized under the laws of Israel with its only office in Tel Aviv, Israel. Debtor had retained Goldfarb to provide legal services in connection with various corporate and securities matters in Israel and compliance with Israeli securities laws. During their business engagement, Goldfarb issued a series of invoices to the Debtor and the Debtor instructed its bank in Israel to transfer the amount from its account to Goldfarb's account. The amount was transferred and after a few days, the Debtor filed for bankruptcy. **Alex Spizz,**

the Chapter 7 Trustee for the Debtor brought an adversary proceeding to avoid and recover the bank transfer made as a preference under sections 547 and 550 of the Bankruptcy Code. The sole issue was whether the presumption against extraterritoriality prevents the Trustee from avoiding the transfer.

The Court relied upon the decisions in *Sec. Investor Prot. Corp. v. BLMIS (In re BLMIS) and Maxwell Commc'n Corp. plc v. Societe Gen. plc (In re Maxwell Commc'n Corp. plc* and concluded that the avoidance provisions of the Bankruptcy Code do not apply extraterritorially because Congress did not intend them to apply extraterritorially. The Court determined that some provisions of the Bankruptcy Code and corresponding jurisdictional sections do contain clear statements that they apply extraterritorially. However, §547 **does not include a clear, affirmative indication that it applies extraterritorially, or allows the trustee to avoid transfers "wherever located," or wherever they occurred.** In the case at bar, the transfer at issue took place in Israel between a U.S. transferor headquartered in Israel and an Israeli transferee, most of the services were also performed in Israel. Since the avoidance provisions do not apply extraterritorially; the Court entered judgment for Goldfarb dismissing the action. The Court also concluded that the focus of Bankruptcy Code §547 is the initial transfer, and that transfer occurred in Israel and as the transfer was not domestic, it cannot be avoided.

New Jersey Court – Relevant Inquiry for Determining Ordinary Course Analysis is Whether Transactions Reflect Divergence from Industry Norms

Dots, LLC v. Milberg Factors, Inc. (In re Dots, LLC), 562 B.R. 286 (Bankr. D.N.J. 2017)

Debtor Dots, LLC was a women's discount clothing retailer. **Defendants Finance One, Inc. and Milberg Factors, Inc** (Factors) operate as financing and factoring companies. The relationships between Dots and the Factors arose out of an arrangement between Dots, the vendors, and the Factors. Dots purchased its products from multiple vendors. Dots placed orders for goods with the vendors, and the Factors approved and purchased the accounts from the vendors. The vendors then shipped goods to Dots, and Dots made payments for those goods directly to the Factors. Significantly, the Factors did not enter into any agreement directly with Dots. Sometime in late 2012 and early 2013, the Factors adjusted the credit lines and reduced the amount of credit made available to the vendors for sales to Dots. This credit line adjustment had the effect of reducing the amount of new inventory that Dots could purchase on credit. To maintain a historically consistent level of inventory purchases and expand credit availability, Dots began to anticipate payments and pay for the goods earlier than required by the terms of their invoices. However, the Factors never formally changed the terms of the vendors' invoices.

Dots filed for bankruptcy and subsequently commenced adversary proceedings against the Defendants to avoid transfers made by Dots to Factors as preferential payments under § 547(b). The **Defendants asserted that the transfers were not voidable because they have valid affirmative defenses under §547(c). According to Dots, the mere fact that the parties' credit relationship changed during the preference period was sufficient to preclude a finding that the challenged transfers were made according to the ordinary business terms.**

The Court disagreed and opined that the examination should be focused primarily upon whether the transactions reflected a divergence from industry norms. **To determine whether the transactions, in this case, were made under ordinary business terms of the creditor's industry, the Court ascertained that it must have a more comprehensive understanding of the sector in which these parties operated and the inquiry must extend into the industry of "factoring sales to clothing retailers.**" Adding further, the Court said that a more extensive research was required to determine the Defendant's ordinary business terms defense, i.e., whether the Factors' credit line adjustments were carried out with the goal of coercing payment, or rather, reducing exposure consistent with industry practices.

The Court also held that the affirmative defenses under §547(c) had to be available in the order that the Defendant deemed most advantageous. The Court also found that the Defendant provided new value under §547(c)(4) in the form of goods because the Defendant held title to the goods that were shipped ultimately to the Debtor. The Court denied the Trustee's Motion for summary judgment.

Trustee Avoids the Transfer as Preference As the Debtor was Insolvent at the Time the Alleged Transfers Were Made

Lanik v. Smith (In re Cox Motor Express of Greensboro, Inc.), Nos. 14-10468, 15-02023, 2017 Bankr. LEXIS 233 (U.S. Bankr. M.D.N.C. Jan. 27, 2017)

Debtor Cox Motor Express of Greensboro, Inc., was a trucking company. **Defendant James W. Smith Jr.** was the President of the Debtor. The Trustee brought a complaint against the Defendant, alleging that the transfers from the Debtor to the Defendant constituted preferential transfers under §547(b) and therefore he was entitled to recover these transfers. The Trustee also sought additional sanctions under FRCP 37 and §105 against the Defendant and his attorney, alleging that the Defendant made misrepresentations to the Trustee and the Court regarding the disputed payment, concealed certain real property and also defamed the Trustee and his counsel. **The Court found that the Debtor was insolvent at the time of the alleged preferential transfers for purposes of §547(b)(3) because its liabilities exceeded its assets as on the petition date.** The Court added that although the Debtor's assets should properly be valued as a going concern rather than at liquidation, the Debtor's tax return tended to show that the Debtor was in serious financial difficulty and insolvent on the date of the first transfer. The Court thus ruled that the alleged transfers from the Debtor to the Defendant constituted avoidable preferential transfers, subject to the affirmative defense of new value.

The Court then, applied the net result rule from *Meredith Manor* to determine the amount of new value advanced and stated that a court should consider the 90-day preference period and calculate the difference between the total preference and the total advances, provided that each advance is used to offset only prior (although not necessarily immediately prior preferences). Further, the new value amounts may not be used to offset any preferential payments made after the new value is advanced. The Court thus determined that although the loans made by the Defendant during the preference period

constituted "new value" under §547(c)(4), the "new value" amounts could not be used to offset any preferential payments made after the new value was advanced. The Court ruled that under the methods dictated by the Fourth Circuit in *Meredith Manor*, the net avoidable preference in this case was $97,600.

The Court also denied the Trustee's motion to impose sanctions. The Court added that **although the Defendant's conduct was liable to be sanctioned under FRCP 37, the Court declined to impose sanctions because the Trustee failed to offer any evidence of the damages directly caused by the Defendant's conduct.**

Trustee Failed to Demonstrate that a Genuine Issue of Material Fact Exists as to the Debtor's Solvency on the Two Transfers

Roach v. Skidmore Coll. (In re Dunston), Nos. 14-41799-EJC, 15-04048-EJC, 2017 Bankr. LEXIS 282 (U.S. Bankr. S.D. Ga. Jan. 31, 2017)

Debtor Dr. Leslie Kyrin Dunston is a medical doctor specializing in obstetrics and gynecology. The Debtor filed for Chapter 7 bankruptcy relief due to an acute cash-flow shortage that occurred when her medical practices experienced difficulty collecting reimbursements from medical insurance companies for services performed. The Trustee commenced adversary proceeding to avoid three payments made by the Debtor to **Defendant Skidmore College** for her daughter's tuition and other costs of attendance. The Trustee alleged that the three transfers to Skidmore were avoidable and recoverable under §§ 548(a)(1)(B) and 550. Skidmore alleged that the Trustee's complaint failed to state a claim because the Trustee cannot meet his burden of proof as to each of the elements of §548(a)(1).

The Court stated that §548(a)(1)(B) requires a Trustee to establish three things with respect to each transfer - the Debtor transferred an interest of the Debtor in property to Skidmore within the two-year reach back period; the Debtor received less than a reasonably equivalent value in exchange for the transfer; and the Debtor was insolvent on the date the transfer was made or became insolvent as a result of the transfer. The Court concluded that the college was not entitled to summary judgment based on its argument that the funds were excluded from property of the estate under 11 U.S.C.S. § 541(b)(6) because facts were in dispute regarding the tracing of the funds. The Court also added that the Defendant was also not entitled to summary judgment on the basis that the Debtor received reasonably equivalent value in exchange for the transfers because the benefit was for the daughter. However, the Court ruled that the Defendant was entitled to summary judgment on first two payments because the Trustee failed to demonstrate a genuine issue of material fact regarding the Debtor's solvency on those dates.

A New York Court Grants Defendants' Motions to Dismiss Because Trustee Failed to Sufficiently Allege that the Debtor Entered the LBO with Actual Intent to Hinder, Delay, or Defraud its Creditors

Kirschner v. Fitzsimons (In re Tribune Co. Fraudulent Conveyance Litig.), No. 11-md-2296 (RJS), 2017 U.S. Dist. LEXIS 3039 (S.D.N.Y. Jan. 6, 2017)

Debtor Tribune Company was America's largest media and entertainment company, owning numerous radio and television stations and major newspapers. Post the 2007 leveraged buyout of the Debtor, the multi-district litigation started, and subsequently, the Debtor filed for bankruptcy in 2008. The **Tribune's litigation trustee, Marc Kirschner** sought to clawback money that was distributed to various Defendants. The Defendants included various entities and individuals, including over $8 billion paid to the Tribune's shareholders in exchange for their shares in Tribune. The Defendants filed motions to dismiss the Trustee's actual fraudulent conveyance claim related to the transfers. The Court found that there was no dispute that the alleged transfers occurred in the two years preceding Tribune's bankruptcy filing on December 8, 2008. Accordingly, the sole issue was whether the Trustee had alleged sufficient facts to support a strong inference that Tribune, as the transferor, acted with an actual intent to hinder, delay, or defraud its creditors.

The Court found that the Trustee failed to plead facts sufficient to allege that its directors possessed actual intent to hinder, delay, or defraud Tribune's creditors through the LBO. The Court concluded that the Trustee's attempt to impute the officer Defendants' intent to the corporation was unjustified. There was no showing whether the Debtor's directors knew or were consciously indifferent to the fact that the LBO would render Tribune insolvent. Further, the Trustee did not sufficiently allege strong circumstantial evidence of conscious misbehavior or recklessness on the independent directors' part. The Trustee also failed to make any allegations of financial or other personal ties between the independent directors and the parties that received special incentives upon completion of the LBO that could have affected the impartiality of the independent directors. The Court concluded that the badges of fraud alleged by the Trustee were insufficient to raise a strong inference that the independent directors acted with an actual intent to hinder, delay, or defraud Tribune's creditors. Accordingly, the Court ruled that the Trustee failed to raise a strong inference of fraudulent intent on the part of the independent directors under the traditional badges-of-fraud analysis and also failed to state a claim upon which relief may be granted. The Court granted the Defendants' motion to dismiss.

Snapshot of Clawback Cases Filed

Groups of Adversary Proceedings filed by the Debtors	Total cases filed	Name of Judge	Largest Case in the group	Claim Amount of the Largest Case (in USD)	Petition Date	District
Shasa USA LLC	81	Ernest M. Robles	Shanghai Jingtong International Trading Co.	783,804.50	2/4/2015	Central District of California

SkyMall, LLC	60	Brenda K. Martin	Quad/Graphics, Inc.	1,203,288.78	1/22/2015	District of Arizona
C. Wonder LLC	52	Michael B. Kaplan	Marc Fisher Footwear	869,051.28	1/22/2015	District of New Jersey
S&S Steel Services, Inc.	34	Jeffrey J. Graham	Anchor Steel, LLC	109,686.55	8/31/2015	Southern District of Indiana
Crescent & Sprague Supply Co., Inc.	31	Charles M Caldwell	Schneider Electric USA, Inc.	171,700.31	7/10/2015	Southern District of Ohio
Enrizon Worldwide, Inc.	25	Thomas J. Catliota	Andre L Roberts	34,000.00	1/21/2015	District of Maryland
Neighborhood Health Services Corporation	15	Vincent F. Papalia	Local 74 USWU (Health)	73,440.00	1/7/2015	District of New Jersey
WBH Energy, LP and WBH Energy GP, LLC	14	H. Christopher Mott	Nottus Energy Resources LLC	211,221.26	1/4/2015	Western District of Texas
Health Diagnostic Laboratory, Inc.	13	Kevin R. Huennekens	BioPool U.S., Inc.	59,326.75	6/7/2015	Eastern District of Virginia
VPH Pharmacy, Inc.	12	Daniel S. Opperman	-	-	1/13/2017	Eastern District of Michigan
ITS Engineered Systems, Inc. and Official Committee of Unsecured Creditors of ITSE	10	Karen K. Brown	Tri-State Supply Company	166,498.38	4/17/2015	Southern District of Texas

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
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