THE GOOD FAITH INQUIRY: WHAT ABOUT THE WORKER ANTS?

INTRODUCTION

Charming leader, credible scientist, media darling, political icon—each of these terms could be used to describe Wang Fengyou, chief executive officer and chairman of the Yilishen Tianxi Group, which was founded in 1999.[1] Wang Fengyou and his managers advertised an inconceivable investment opportunity for impoverished farmers throughout China.[2] For the meager price of 10,000 yuan,[3] the farmers would receive a box of special ants that necessitated royal treatment for the next ninety days.[4] After about three months of meticulously feeding the ants egg yolk, sugar water, and cake, the company would collect the dead ants from the farmers, and each farmer was promised a thirty percent return profit.[5] The ants were subsequently crushed into a powder to be used as an aphrodisiac, and many well-known political and pop culture figures spread tales of the powder's success throughout the Chinese media.[6] For eight years, hundreds of thousands of farmers were charmed into participating in this get rich quick system, and the scheme collected more than ten billion yuan in total.[7]

Unbeknownst to these farmers and media advertisers, the "magical" effects of the alleged aphrodisiac were illusory, and their promised profits were simply recycled investor deposits—the hallmark of a Ponzi scheme.[8]

1. *See* Rupert Taylor, *Chinese Ant Farming Scam*, SOAPBOXIE (Nov. 2, 2020), https://soapboxie.com/economy/Chinese-Ant-Farming-Scam [https://perma.cc/2MPH-5B7Z].
2. *See id.*
3. 10,000 yuan is roughly equivalent to $1,600 USD. *See id.* In 2015, the annual income for farmers was predicted to exceed 11,000 yuan (currently equivalent to $1,695 USD), illustrating that these farmers were investing nearly their entire year's earnings into this scheme. *See Farmer Income to Reach 11,000 Yuan in 2015*, CHINA.ORG.CN (Apr. 22, 2015), http://www.china.org.cn/business/2015-04/22/content_35392703.htm [https://perma.cc/7MMX-QEGG].
4. *See* Taylor, *supra* note 1.
5. *See id.*
6. *See id. See also A Chinese Pyramid Scheme Built on an Anthill*, ASIA SENTINEL (Dec. 3, 2007), https://www.asiasentinel.com/p/a-chinese-pyramid-scheme-built-on-an-anthill [https://perma.cc/HN6G-WCTZ]. Ant products, which are significantly more common in China than in Western medicine, "are believed to relieve a wide variety of ailments, heighten the physical stamina of athletes, combat aging, improve immunity and, of course, increase male potency." *Id.*
7. *Sting in the Tail for China Ant Aphrodisiac Scheme*, REUTERS (Dec. 12, 2007, 10:27 PM), https://www.reuters.com/article/idUSPEK90480 [https://perma.cc/YQ56-V8ED]. As of November 5, 2021, the value of 10 billion yuan is roughly 1.56 billion USD. *Chinese Yuan (CNY) to US Dollar (USD) Exchange Rate History*, EXCH. RATES UK, https://www.exchangerates.org.uk/CNY-USD-exchange-rate-history.html [https://perma.cc/EH5K-ZCB5].
8. *See* James Chen, *Ponzi Scheme*, INVESTOPEDIA (Aug. 23, 2021), https://www.investopedia.com/terms/p/ponzischeme.asp [https://perma.cc/8QTB-VMP2] ("A Ponzi scheme is a fraudulent investing scam which generates returns for earlier investors with money taken from later investors.").

"At the end of 2007, the Yilishen Tianxi Group filed for bankruptcy," and almost a million investors were stripped of their life savings.[9] "Huge street protests"[10] and riots ensued, and the Chinese government worked rapidly to cover the rampant internet and blog posts that stemmed from the Ponzi scheme.[11] In this tragic instance, clearly Wang Fengyou was culpable for his intentional creation of the fraudulent scheme, meaning he faced criminal charges and was not entitled to any earnings from the illegal scheme.[12] However, should the celebrities and political figures who advertised the elixir be culpable or be entitled to their earned wages? What about Fengyou's managers? What about the ant farmers themselves, who technically propagated the scheme by cultivating the ants to formulate the elixir?[13]

There is a significant amount of scholarship on whether an unknowing *investor* can retain his or her investment in the Ponzi scheme based on an affirmative good faith defense.[14] One aspect of Ponzi schemes that is frequently overlooked is the unknowing *employee*, who likely left his or her original job to come work for someone they viewed as charming, brilliant, and business savvy. If legitimately unaware of the nature of their boss's work, should their labor entitle them to keep the wages they earned while working for the scheme?

This Note will explore the contested definitions of "reasonably equivalent value" and "good faith" in the context of the worker, rather than the investor. Part II will discuss background terms and definitions

9. Taylor, *supra* note 1. *See infra* note 13 and accompanying text.

10. Taylor, *supra* note 1.

11. *See* John Kennedy, *China: Bankrupt Ant Farmers Prepare to Protest*, GLOB. VOICES (Nov. 20, 2007, 11:38 PM), https://globalvoices.org/2007/11/20/china-bankrupt-ant-farmers-prepare-to-protest/ [https://perma.cc/HE6T-7ALY] (compiling blog posts from troubled Ponzi scheme victims and family members).

12. "Wang [Fengyou] was arrested [in China], tried, [and] found guilty of 'instigating social unrest,' and sentenced to death." Taylor, *supra* note 1.

13. Note that the ant farmers were most accurately the *investors* in the Yilishen Tianaxi scheme. *See id.* However, the farmers pose an interesting hypothetical, as they really function as both employees (by taking care of the ants according to specified instructions) and investors (investing in the scheme for the chance to receive a high return). *See id.*

14. *See infra* Part II. Although the cases involving investors in Ponzi schemes are not the focus of this Note, the cases are illustrative in examining the various standards that exist to evaluate the ways in which one could examine a Ponzi scheme employee's labor. For example, in *Janvey v. Brown* (further examined in Part II *infra*), investors that suffered at the hands of a Ponzi scheme sought disgorgement of the profits, alleging the profits were not "for value" simply because they were taken from other investors. *See* 767 F.3d 430, 442 (5th Cir. 2014). The court held that those who invested early and therefore made a significant amount of profit were not entitled to those profits; these "Net Winners" were only entitled to the principal amount of their investment. *See id.* at 441. If these investors were entitled to the amount of their original investment, why would an employee not be entitled to his or her wages?

surrounding the good faith affirmative defense.[15] Part III will explore the different approaches various courts have taken regarding whether an employee or a service provider can contribute value at all to a Ponzi scheme.[16] Part IV will delve into the various schemas in existence for determining the "good faith" of an employee or a service provider in the Ponzi scheme context.[17] Because neither the Bankruptcy Code nor the parallel state law defines good faith,[18] there is significant room for growth in delineating a test that consistently evaluates good faith and deters participation in Ponzi schemes. After examining these varying definitions and standards, this Note proposes a standard to which courts should look in evaluating the affirmative good faith defense for employees.[19] First, transfers in Ponzi schemes should not be per se valueless. Second, a three-category evaluation should be implemented to gauge the employee's level of involvement in the Ponzi scheme in order to determine what level of good faith analysis scrutiny should be applied. Part VI will evaluate the policy arguments implicated by implementation of this two-part proposal.[20] Not only will this new standard promote much-needed consistency in Ponzi scheme clawback actions, but it will also adhere to the principles of equity, strike a compromise between protecting unknowing employees and investors, and encourage vigilance in accepting employment, especially within the higher levels of the company.

I. BACKGROUND

In the United States, Ponzi schemes surged in 2019.[21] Sixty Ponzi schemes were uncovered, revealing a collective $3.245 billion in misappropriated investor funds.[22] "Ponzi schemes are based on fraudulent investment management services . . . ."[23] Usually, an unknowing investor will "contribute money to [a] 'portfolio manager,'"[24] who lures the investor

15. *See infra* Part II.
16. *See infra* Sections III.A–B.
17. *See infra* Part IV.
18. *See generally* 11 U.S.C. § 548; UNIF. FRAUDULENT TRANSFER ACT (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1984).
19. *See infra* Part V.
20. *See infra* Part VI.
21. *See* Jordan Maglich, *Ponzi Schemes Surge in 2019 - Coincidence or Cause for Concern?*, PONZITRACKER (Jan. 16, 2020), https://www.ponzitracker.com/home/ponzi-schemes-surge-in-2019-anomaly-or-cause-for-alarm [https://perma.cc/5FZD-KW48].
22. *Id.*
23. Arthur Pinkasovitch, *Ponzi vs: Pyramid Scheme: What's the Difference?*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/09/ponzi-vs-pyramid.asp [https://perma.cc/93FJ-MW7E] (Jan. 9, 2021).
24. *Id.*

in by promising them unreasonably high returns. The name Ponzi scheme originated from Charles Ponzi, "who promised investors [fifty percent] returns on investments in" just ninety days.[25] When an investor wants their money back, they are bought out with money from other later investors, creating a cyclical cash flow that can only sustain itself as long as investors continue to buy into the scheme.[26] After a Ponzi scheme inevitably collapses like a house of cards,[27] the consequences leave the leaders facing criminal charges.[28] However, the civil lawsuits that usually ensue—with every participant trying to claw back his or her investment, unknowing family members making ancillary claims, and employees battling avoidance actions after losing everything themselves—are usually very complicated, lose-lose situations.[29]

Beyond the litany of lawsuits that may ensue upon the collapse of a Ponzi scheme, the end result of such a collapse is often bankruptcy.[30] In bankruptcy, a trustee[31] steps in to administer the case and liquidate the

25. Stephanie Yang & Grace Kay, *Bernie Madoff Died in Prison After Carrying Out the Largest Ponzi Scheme in History—Here's How it Worked*, BUS. INSIDER (Apr. 14, 2021, 1:08 PM), https://www.businessinsider.com/how-bernie-madoffs-ponzi-scheme-worked-2014-7 [https://perma.cc/T3V4-XZY7].

26. *See* Pinkasovitch, *supra* note 23.

27.

> Ponzi schemes aren't usually very sustainable. The setup eventually falls apart after [1] the operator takes the remaining investment money and runs, [2] new investors become harder to find—meaning the flow of cash dies out— and [3] too many current investors begin to pull out and request their returns.

Yang & Kay, *supra* note 25. *See also* Merrill v. Abbott (*In re* Indep. Clearing House Co.), 77 B.R. 843, 860 (Bankr. D. Utah 1987) ("A Ponzi scheme cannot work forever. The investor pool is a limited resource and will eventually run dry.").

28. Bernie Madoff, for example, pled guilty to eleven criminal counts related to his infamous Ponzi scheme, including securities fraud, and was sentenced to 150 years in prison. *See* Dan Mangan & Jim Forkin, *Ponzi Scheme King Bernie Madoff Denied Compassionate Prison Release by Federal Judge*, CNBC (June 4, 2020, 4:48 PM), https://www.cnbc.com/2020/06/04/bernie-madoff-denied-prison-release-in-fraud-case.html [https://perma.cc/KJ52-9RBW]. In addition to securities fraud and mail fraud, perpetrators of Ponzi schemes may also face charges of wire fraud or commodities fraud. *See* *Pyramid and Ponzi Schemes*, EISNER GORIN LLP, https://www.thefederalcriminalattorneys.com/pyramid-and-ponzi-schemes/ [https://perma.cc/YFC6-JNL5].

29. *See, e.g.*, *Madoff Lawsuits Chase $50 Billion in Losses*, FINDLAW (Mar. 26, 2008), https://corporate.findlaw.com/finance/madoff-lawsuits-chase-50-billion-in-losses.html [https://perma.cc/BQ74-LFXY] (explaining a variety of the civil lawsuits that ensued following the collapse of the Bernie Madoff Ponzi scheme).

30. *See* MARC HIRSCHFIELD & GEORGE KLIDONAS, AVOIDANCE ACTIONS IN PONZI SCHEME BANKRUPTCY CASES 1 (2011), https://www.bakerlaw.com/files/Uploads/Documents/News/Articles/BUSINESS/2011/ABA_HIrschfield_Klidonas_April-2011.pdf [https://perma.cc/F73V-HAGV].

31. In the Ponzi scheme context, "Ponzi scheme bankruptcies always result in the appointment of a trustee to displace the fraudulent Ponzi scheme perpetrator," or the debtor. *Id.* "Trustees act under the authority of the Bankruptcy Code . . . with the objective of maximizing returns for the people who lost money in connection with a Ponzi scheme." Kathy Bazoian Phelps, *How Much Control Does a*

debtor's nonexempt assets.[32] The trustee has "avoiding" powers that can be utilized to "undo a transfer of money or property made during a certain period of time before the filing of the bankruptcy petition."[33] "By avoiding a particular transfer of property," the trustee can force the return of the property to the creditors—the victims/investors—of the Ponzi scheme.[34] The statutory framework guiding these actions to recover money lost in a Ponzi scheme is contained in the Bankruptcy Code and the Uniform Fraudulent Transfer Act (UFTA).[35] The Bankruptcy Code governs fraudulent transfer law at the federal level, while the UFTA governs fraudulent transfer law for states.[36]

The Bankruptcy Code section 548 gives the trustee in bankruptcy this power to avoid, as fraudulent conveyances, certain transactions in which the debtor transferred property or incurred an obligation.[37] Section 548(a)(1)(A) empowers the trustee to avoid transfers made or obligations "incurred with actual intent to hinder, delay, or defraud" creditors to whom the debtor was then or thereafter became obligated.[38] Section 548(a)(1)(B) empowers the trustee to avoid constructively fraudulent transfers or obligations.[39] Although frequently challenged in bankruptcy scholarship, there exists a presumption that Ponzi schemes operate with actual fraud, or intent to hinder, delay, or defraud a Ponzi debtor's creditors.[40] Therefore, operating

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Trustee Have in a Ponzi Scheme Case?, LEXISNEXIS (Jan. 21, 2014), https://www.lexisnexis.com/legalnewsroom/bankruptcy/b/bankruptcy-law-blog/posts/how-much-control-does-a-trustee-have-in-a-ponzi-scheme-case [https://perma.cc/FA7P-M4JH].

32. *See Chapter 11 – Bankruptcy Basics*, U.S. CTS., https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics [https://perma.cc/G67Q-D36U].

33. *Id.*

34. *Id.*

35. *See* UNIF. FRAUDULENT TRANSFER ACT (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1984). "[T]he Uniform Fraudulent Transfer Act . . . is the most prevalent state statute regarding fraudulent transfers, with forty-three states and the District of Columbia having adopted some version of the Act." Karen E. Nelson, Note, *Turning Winners into Losers: Ponzi Scheme Avoidance Law and the Inequity of Clawbacks*, 95 MINN. L. REV. 1456, 1460–61 (2011). Some remaining states retain the old Uniform Fraudulent Conveyance Act (UFCA). *See id.* at 1461–62.

36. State fraudulent conveyance law, UFTA, "is applicable outside of bankruptcy as well as in bankruptcy." John D. Ayer, Michael L. Bernstein & Jonathan Frieland, *The Trustee's Power to Avoid Fraudulent Transfers*, AM. BANKR. INST. (May 1, 2004), https://www.abi.org/abi-journal/the-trustees-power-to-avoid-fraudulent-transfers [https://perma.cc/Y6NL-NEVV]. The Bankruptcy Code fraudulent conveyance sections only apply in bankruptcy court. *See id.* The UFTA in most respects parallels the Bankruptcy Code's fraudulent conveyance provisions; however, a discussion of both statutory frameworks is useful to incorporate the maximum amount of state and federal case law to evaluate the differing views concerning the vocabulary and concepts used throughout the statutes. *See id.*

37. *See* 11 U.S.C. § 548.

38. 11 U.S.C. § 548(a)(1)(A).

39. *See* 11 U.S.C. § 548(a)(1)(B).

40. The Ponzi scheme "presumption" of actual intent to defraud creditors is derived from *Conroy v. Shott*, 363 F.2d 90 (6th Cir. 1966) and *Merrill v. Abbott* (*In re Indep. Clearing House Co.*), 77 B.R. 843 (Bankr. D. Utah 1987), which are two of the earliest decisions holding that payouts to defrauded

under the presumption that actual intent to defraud exists, the affirmative defense that creditors must utilize is dubbed the "Good Faith Defense":

> Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that *takes for valu*e and *in good faith* has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee *gave value to the debtor in exchange* for such transfer or obligation.[41]

This provision allows a transferee that has stepped into the place of a creditor to recover a "transfer" (money invested) if the transfer was given to the Ponzi scheme operator (1) for value, and (2) in good faith.[42]

Section 4 of the UFTA is fashioned similarly to the Bankruptcy Code. There is a section empowering the trustee to avoid fraudulent transfers made with actual intent to defraud,[43] and there is a section empowering the trustee to avoid fraudulent transfers with constructive intent.[44] Unlike the Bankruptcy Code, the UFTA delineates eleven "badges of fraud"[45] that courts can look to in interpreting the intent of a debtor.[46] These badges of

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Ponzi investors were made with intent to hinder, delay, or defraud creditors. Some scholars argue that this presumption's existence creates many potential concerns and should be eliminated from jurisprudence. *See, e.g.*, RALPH BRUBAKER, EXPERT REPORT REGARDING THE PONZI SCHEME "PRESUMPTION" OF ACTUAL INTENT TO DEFRAUD CREDITORS 44 (2013). Instead, there should be an individualized inquiry into whether there was actual fraud (actual intent to hinder creditors) or constructive fraud (there was no actual intent to hinder creditors, but there was no reasonably equivalent value exchanged). *See id.* at 13. Some reasons cited in favor of destroying the Ponzi scheme presumption include: (1) a presumption is inconsistent with the purposeful design in codification of constructive fraud to preclude conclusive legal presumptions of intent to defraud; (2) a presumption may be inconsistent with the trustee's burden of proof regarding actual intent to defraud; (3) a presumption may have the effect of making an actual fraud claim a restitutionary claim that relieves the trustee of defenses applicable to a restitution claim, such as Bankruptcy Code § 546(e). *See id.* at 36–45. Although there is a plethora of scholarship attacking the "Ponzi scheme presumption" of actual fraud, for the purposes of this Note, actual fraud is asserted, triggering the § 548 affirmative good faith defense or its state law equivalent. *See* 11 U.S.C. § 548(a)(1)(A).

41. 11 U.S.C. § 548(c) (emphasis added). Additionally, the section goes on to define "value" as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." § 548(d)(2)(A). The Bankruptcy Code does not define the term "good faith."

42. *See* 11. U.S.C.A. § 548(c).

43. UNIF. FRAUDULENT TRANSFER ACT § 4(a)(1) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1984).

44. *See id.* at § 4(a)(2).

45. *See id.* at § 4 cmt. 5.

46. *See id.* at § 4(b). ("In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether: (1) the transfer or obligation was to an insider; (2) the debtor retained possession or control of the property transferred after the transfer; (3) the transfer or obligation was disclosed or concealed; (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; (5) the transfer was of substantially all the debtor's assets; (6) the

fraud operate similarly to the Ponzi scheme presumption because a majority of the factors tend to illustrate the Ponzi scheme mastermind operated with actual intent.[47] For example, "the relationship among the parties and the secrecy, haste, [and] unusualness of the transaction" will often be sufficient to tip the badges of fraud in favor of inferring actual intent.[48] Similarly to the Bankruptcy Code, section 8 of the UFTA also establishes a good faith defense: "[a] transfer or obligation is not voidable under Section 4(a)(1) against a person who took in good faith and for a reasonably equivalent value [given the debtor] or against any subsequent transferee or obligee."[49] Therefore, the parallel touchstones for a creditor's ability to retain their transfer are (1) reasonably equivalent value, and (2) good faith.[50]

II. "REASONABLY EQUIVALENT VALUE"

There is little consensus about whether, and under what circumstances, consideration provided to a Ponzi scheme can constitute "reasonably equivalent value."[51] One line of cases holds that the reasonably equivalent value element is lacking when someone is paid for aiding a scheme.[52] Even if the employee is completely oblivious to the illegal nature of the scheme, these cases hold the employee did not give anything of value for the payment they received.[53] The Ponzi scheme leader or its creditors/victims did not receive anything of value from services aimed at encouraging more

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debtor absconded; (7) the debtor removed or concealed assets; (8) 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; (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.").

47. *See, e.g.*, Sharp Int'l Corp. v. State St. Bank & Tr. Co. (*In re* Sharp Int'l Corp.), 403 F.3d 43, 56 (2d Cir. 2005).

48. *Id.* (quoting HBE Leasing Corp. v. Frank, 48 F.3d 623, 639 (2d Cir. 1995)).

49. UNIF. FRAUDULENT TRANSFER ACT § 8(a) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1984).

50. *See id.*

51. For a discussion of the various ways in which courts have determined the meaning of reasonable equivalence, see David M. Schilli, *Defining Reasonably Equivalent Value Under Section 548(a) of the Bankruptcy Code: Is* Ristich *the Answer?*, 44 WASH. & LEE L. REV. 237 (1987). For example, some courts have held that reasonably equivalent means at least 70% of the fair market value of the services or property. *See id.* at 241 n.10. This discussion is beyond the bounds of this Note, which focuses on courts' split treatment of the noun (value), rather than the adjective (reasonably equivalent) in the term "reasonably equivalent value."

52. *See, e.g.*, Warfield v. Byron, 436 F.3d 551 (5th Cir. 2006); Janvey v. Brown, 767 F.3d 430 (5th Cir. 2014); Randy v. Houck (*In re* Randy), 189 B.R. 425 (Bankr. N.D. Ill. 1995).

53. *See Warfield*, 436 F.3d at 560.

investors to invest; in fact, the exact opposite occurs—the entity only becomes further entrenched in debt.[54]

The opposing line of cases holds that the good faith or bad faith of each individual employee should be evaluated on a case-by-case basis because their services were not of no value per se.[55] Performing services in good faith at a market value hourly rate, for example, has value from a logical standpoint.[56] The latter line of reasoning should be adopted by the court system. The subsequent good faith inquiry will continue to safeguard the policy rationales supporting the former line of cases.[57] Additionally, principles of equity and restitution advise against this black-and-white interpretation of reasonably equivalent value.[58]

A. Inherently No Value in Ponzi Scheme Services

The Fifth Circuit is the principal circuit holding that there is inherently no value in a Ponzi scheme, and therefore, commissions are voidable.[59] In *Warfield v. Byron*,[60] the Fifth Circuit held that commissions paid to a broker in exchange for securing new investments into a Ponzi scheme are voidable, even assuming the broker was unaware of the fraud.[61] In *Warfield*, both of

54. *See* Peter A. Davidson, *Fore! Ponzi Scheme Lands the Golf Channel in the Rough*, ERVIN, COHEN & JESSUP LLP (June 3, 2015), https://www.ecjlaw.com/ecj-blog/fore-ponzi-scheme-lands-the-golf-channel [https://perma.cc/8FAV-JL8Y].

55. *See, e.g.*, Churchill Mortg. Inv. Corp. v. Sixty-Five Brokers (*In re* Churchill Mortg. Inv. Corp.), 256 B.R. 664 (Bankr. S.D.N.Y. 2000); World Vision Ent., Inc. v. Greenmark, L.L.C. (*In re* World Vision Ent., Inc.), 275 B.R. 641 (Bankr. M.D. Fla. 2002); First Com. Mgmt., Inc v. Reinhardt (*In re* First Com. Mgmt., Inc.), 279 B.R. 230 (Bankr. N.D. Ill. 2002).

56. *See In re World Vision Ent., Inc.*, 275 B.R. at 658–59.

57. *See infra* Part V.

58. *See infra* Part V.

59. However, interestingly there is some tension within the Fifth Circuit regarding this principle. In one notable case, the Golf Channel provided advertisement services to a Ponzi scheme, and they were subsequently sued for the wages that they gained from their services. *See* Janvey v. Golf Channel, Inc., 487 S.W.3d 560, 564–65 (Tex. 2016). After making its way through the bankruptcy courts of Texas, which each held that services supporting a Ponzi scheme were per se of no value, the Fifth Circuit vacated its opinion and certified a question to the Texas Supreme Court: "what showing of 'value' under [the Texas Uniform Fraudulent Transfer Act] is sufficient for . . . [a] [good faith] affirmative defense?" *Id.* at 566 (alteration in original) (quoting Janvey v. Golf Channel, Inc., 792 F.3d 539, 547 (5th Cir. 2015) (per curiam)). The court evaluated the current split in thought regarding a service's "value" in the context of a Ponzi scheme and eventually ruled contrary to the Fifth Circuit's established precedent:

> In this case, Golf Channel's media-advertising services had objective value and utility from a reasonable creditor's perspective at the time of the transaction, regardless of Stanford's financial solvency at the time. . . . Even if the media-advertising services utterly failed in their ostensible purpose of attracting more business—and thus only served to deplete Stanford's assets—the inherent value of those services nonetheless existed at the time of the transaction.

Id. at 581–82.

60. Warfield v. Byron, 436 F.3d 551 (5th Cir. 2006).

61. *See id.* at 558–60.

the defendants who worked for the Ponzi scheme were also investors in the Ponzi scheme.[62] The scheme involved an offshore trading program that would allegedly pay "returns of at least four percent per month."[63] The defendants received immense profits on their initial investments, and they also solicited other individuals to participate in the scheme.[64] Claiming that the good faith defense should be available to them, the defendants contended their broker services constituted reasonably equivalent value, and their earnings should not be voidable.[65] However, the court refused to even entertain the question of good faith, as there was per se no reasonably equivalent value exchanged: "[b]ecause the . . . Trading Program never earned any legitimate income, the 'commissions' and 'earnings' received by [the defendants] were funds skimmed from later investors' payments into the Ponzi scheme."[66] The court concluded, "[i]t takes cheek to contend that in exchange for the payments he received, the . . . Ponzi scheme benefitted from his efforts to extend the fraud by securing new investments."[67]

Warfield is frequently cited in similar cases, mainly to support the proposition that "[t]he primary consideration in analyzing the exchange of value for any transfer is the degree to which the transferor's net worth is preserved."[68] Because services furthering investment in the Ponzi scheme exacerbate the transferor's net worth, thus perpetuating the harm from the scheme, an employee should not be able to recover his or her wages.[69]

Various bankruptcy courts have also adhered to this view that there is no value in a Ponzi scheme.[70] For example, *In re Randy* involved a Ponzi scheme that had brokers recruit new investors.[71] In evaluating the potential good faith defense available to the brokers to keep their commissions, the court recognized that "the brokers' efforts to convince investors to roll over their principal investments only perpetuated the Ponzi scheme," even if they

62. *See id.* at 555.
63. *Id.* at 554.
64. *See id.* at 555.
65. *See id.* at 559.
66. *Id.* at 555.
67. *Id.* at 560.
68. *Id. See also* Hoffman v. Markowitz, 746 F. App'x 641 (9th Cir. 2018) (using the *Warfield v. Byron* principle to hold that because the only services exchanged in the case exacerbated the Ponzi scheme by recruiting more investors, the employees' referral fees were subject to disgorgement, as they did not provide reasonably equivalent value); Mills v. Billings, NO. 3:18-CV-679-CWR-FKB, 2019 WL 3877853, at *2 (S.D. Miss. Aug. 16, 2019); S.E.C. v. Res. Dev. Intern., L.L.C., 487 F.3d 295, 301 (5th Cir. 2007).
69. *See Warfield*, 436 F.3d 551, 560.
70. *See, e.g.*, Martino v. Edison Worldwide Cap. (*In re* Randy), 189 B.R. 425 (Bankr. N.D. Ill. 1995); Blazo Corp. v. RHS & Assocs. (*In re* Blazo Corp.), 1994 WL 92405 (Bankr. N.D. Ohio Feb. 25, 1994).
71. *See In re Randy*, 189 B.R. at 431.

acted in good faith.[72] The *Randy* court looked at the brokers' actions as part of an illegal contract, and "one who has himself participated in a violation of law cannot be permitted to assert in a court of justice any right founded upon, growing upon, or out of the illegal transaction."[73] Although innocent or good faith intentions of one party will usually defeat this generalization, "in some types of cases 'the interest of the public, rather than the equitable . . . [principles], is of determining importance."[74] Therefore, in the same way that an investor cannot enforce his contract for profits in excess of the principal,[75] a broker cannot receive his or her commissions that only further the debtor's Ponzi scheme at the expense of the investors.[76]

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72. *Id.* at 439.

73. *Id.* at 441 (quoting Gibbs & Sterrett Mfg. Co. v. Brucker, 111 U.S. 597, 601 (1884)).

74. *Id.* (quoting Merill v. Abbot (*In re* Indep. Clearing House Co.), 77 B.R. 843, 858 (Bankr. D. Utah 1987)); RESTATEMENT (FIRST) OF CONTRACTS § 599 (AM. L. INST. 1932).

75. As mentioned earlier in the Note, restitution principles and equity principles do not allow an early investor to recover his or her profits at the expense of other investors in the Ponzi scheme. For example*, In re Independent Clearing Hous*e evaluated investors' ability for repayment and separated the investors into "two categories: (1) those who advanced money early and received 'earnings' and repayment of [their] principal [payment] in excess of their initial advance, and (2) those who advanced money and received some payments of 'earnings' or repayments of principal or both but no more than their initial advance." *In re* Indep. Clearing House Co., 77 B.R. at 849. The court concluded that the debtors only received a reasonably equivalent value in exchange for the transfers to a defendant that did not exceed the defendant's principal investment in the Ponzi scheme. *See id.* at 857. This initial payment served as an antecedent debt, and the debtors received value in exchange for the transfers that was the "exact same value—dollar for dollar." *Id.* Any profits above and beyond this value were gained pursuant to an illegal contract that was unenforceable on its face. *See id.* at 857–58. Their innocence—which could generally overcome the unenforceability of the illegal contract—does not in this case preclude the profits not being enforced because enforcement of their contract would hurt the debtors' other creditors by depleting the pool of assets to which they could look for payment of their principal investment. *See id.* at 858. "If the contract were enforced, the party who received the benefits of his contract would be unjustly enriched at the expense of other defrauded undertakers." *Id. See also In re* Taubman, 160 B.R. 964, 970 (Bankr. S.D. Ohio 1993) (separating claims into "A" claims, representing the investors' principal investment, and "B" claims, consisting of their profit).

76. *In re Randy*, 18 B.R. at 441. *But see In re Taubman*, 160 B.R. 964. Services are different from this "exacerbation" of the Ponzi scheme in the following way: profits above and beyond the initial investment have absolutely no value because they just continue to utilize unsuspicious later investors' investments. *See id.* at 986. There is nothing in the estate for the creditors to share; in fact, by perpetuating the Ponzi scheme, the "profit" transfers "exacerbate the harm to creditors by increasing the amount of claims while diminishing the debtor's estate." *Id.* The initial investment is different because the principal payments were payments of an antecedent debt, namely fraud claims that the investor-defendants have as victims of the Ponzi scheme. *See* Janvey v. Brown, 767 F.3d 430, 451 (5th Cir. 2014). However, like the initial investment that exacerbates the Ponzi scheme by contributing to the cyclical nature, services rendered create an antecedent debt. Section 548 defines value as satisfaction of an antecedent debt of the debtor. *See In re Taubman*, 160 B.R. at 985. The service creates the antecedent debt; the market value of the services is the reasonably equivalent value.

B. As Long as Value was Exchanged, Continue to the Good Faith Inquiry

Unlike the more punitive approach utilized by the Fifth Circuit, the Eleventh Circuit determines value on a case-by-case basis for the good faith defense.[77] *In re Financial Federated Title & Trust*[78] involved an employee compensated at a rate of one percent of the gross revenues for various computerizing functions, office networking, performing payroll, and acting as human resource director for a Ponzi scheme.[79] The employee eventually held herself out to the public as a vice president of the corrupt company.[80] Despite her prominent role in the company's business structure, the court recognized that, "[b]y definition, a Ponzi scheme is driven further into insolvency with each transaction."[81] With the overbroad reasoning from cases like *In re Randy*,[82] not even extremely tangential employees who provided services to the Ponzi scheme "could prevent the avoidance of any transfers they received."[83] Rejecting this line of reasoning, the court concluded that a determination of value should focus on the cost of the goods and services provided, "rather than on the impact that the goods and services had on the bankrupt enterprise."[84]

Various bankruptcy courts have also declined to follow the *In re Randy* "per se no value" reasoning,[85] instead holding the good faith of the employees should be evaluated in determining the applicability of a good faith affirmative defense.[86] The leading case in this line of thought that spurred the development of subsequent cases looking to determine value on a case-by-case basis is *In re Universal Clearing House*.[87] The lower

77. *See* Janvey v. Golf Channel, Inc., 487 S.W.3d 560, 578 (Tex. 2016).

78. Orlick v. Kozyak (*In re* Fin. Federated Title & Tr., Inc.), 309 F.3d 1325 (11th Cir. 2002).

79. *See id.* at 1327–28.

80. *See id.* at 1328.

81. *Id.* at 1332.

82. Martino v. Edison Worldwide Cap. (*In re* Randy), 189 B.R. 425, 425 (Bankr. N.D. Ill. 1995) (holding all Ponzi scheme services confer no value, regardless of an actor's good faith).

83. *In re Fin. Federated Title & Tr.*, 309 F.3d at 1332.

84. *Id.*

85. *In re Randy*, 189 B.R. at 442.

86. *See* Merrill v. Allen (*In re* Universal Clearing House Co.), 60 B.R. 985, 1000 (D. Utah 1986) ("[A] determination of whether value was given under section 548 should focus on the value of the goods and services provided rather than on the impact that the goods and services on the bankrupt enterprise."); Churchill Mortg. Inv. Corp. v. Sixty-Five Brokers (*In re* Churchill Mortg. Inv. Corp.), 256 B.R. 664 (Bankr. S.D.N.Y. 2000) (holding that commissions paid to brokers for soliciting investors in good faith were not subject to avoidance); World Vision Ent. Inc. v. Greenmark, L.L.C. (*In re* World Vision Ent., Inc.), 275 B.R. 641, 659–60 (Bankr. M.D. Fla. 2002) (holding courts must assess value and good faith for purposes of section 548(c) on a case-by-case basis looking at the surrounding circumstances and focusing on the precise transfer in question); First Com. Mgmt. Grp., Inc v. Reinhardt (*In re* First Com. Mgmt. Grp., Inc.), 279 B.R. 230 (Bankr. N.D. Ill. 2002) (holding that value and good faith are issues of fact).

87. 60 B.R. 985 (D. Utah 1986).

bankruptcy court reasoned in this case similarly to those mentioned in the previous section;[88] the employees of the Ponzi scheme gave no value because the services that they performed were actually detrimental in that each contract they sold increased the debtors' insolvency.[89] On appeal, the court explicitly held that this type of reasoning could be extended to ridiculous lengths:

> [B]y [this] reasoning, no one who in any way dealt with, worked for, or provided services to the debtors could prevent avoidance of any transfers they received. The debtors' landlord, salaried employees, accountants and attorneys, and utility companies that provided services to the debtors all assisted the debtors in the furtherance of their fraudulent scheme. In spite of this fact, we do not think that the goods and services that these persons and entities provided were without value . . . .[90]

The court ultimately held that the lower court erred in ruling that the services the appellants provided had no legally cognizable value, which in turn permitted the analysis an opportunity to proceed to the second portion of the good faith affirmative defense—the evaluation of the employee's good faith.[91]

III. "IN GOOD FAITH"

Once a court determines whether the recipient of a fraudulent transfer provided value, the court turns to an evaluation of his or her good faith under section 548(c).[92] When relying on the affirmative defense delineated in section 548(c), the transferee "bear[s] the burden of proving their own good faith."[93] Because perpetuating Ponzi schemes by rewarding employees' knowing participation in fraudulent schemes is detrimental to society, evaluating the good faith of the transferee is imperative to determining whether he or she can recover wages.

Neither the Bankruptcy Code, nor the UFTA, nor the legislative history of the Bankruptcy Code provides the definition of good faith or the

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88. *See supra* Section II.A.
89. *See In re Universal Clearing House,* 60 B.R. at 999.
90. *Id.*
91. *See id.* at 1002.
92. *See* Cuthill v. Greenmark, L.L.C. (*In re* World Vision Ent., Inc.), 275 B.R. 641, 658 (Bankr. M.D. Fla. 2002).
93. *Id.*

parameters for determining an actor's good faith.[94] Instead, "courts have constructed the applicable framework for assessing" good faith in a variety of manners.[95] Generally, the courts seem to employ a broad spectrum of options, ranging from utilizing an objective standard to a subjective standard and everywhere in between.

A. The Objective Good Faith Inquiry

Several bankruptcy courts adhere to the objective standard in undertaking an analysis of the good faith affirmative defense under section 548(c).[96] *In re World Vision Entertainment*, for example, first held that a broker's services to a Ponzi scheme had value.[97] In turning to an evaluation of the good faith of these brokers, the court explicitly said, "[g]ood faith is judged using an objective standard."[98] The court pointed to various facts the transferee or employee (specifically, the brokers in *In re World Vision*) objectively knew or should have known indicating the business/entity operated fraudulently to inform the good faith inquiry.[99] Looking at broker employees specifically, the court subsequently defined the steps a prudent broker acting in good faith would take before selling the Ponzi scheme product.[100] Utilizing this objective standard, the court determined none of the defendants took action to "determine if the debtor was a legitimate business or [tried] to assess the debtor's financial condition."[101] Therefore,

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94. *See* Christopher Hopkins, *I Didn't Know, I Swear! Section 548(c)'s Good-Faith Defense to Fraudulent Transfer Actions*, WEIL RESTRUCTURING (Mar. 18, 2014), https://business-finance-restructuring.weil.com/avoidance-actions/i-didnt-know-i-swear-section-548cs-good-faith-defense-to-fraudulent-transfer-actions/ [https://perma.cc/PV8E-GWV4]. *See also In re* World Vision Ent., Inc., 275 B.R. at 659 ("Good faith is not a precise, defined term."); Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, L.L.C. (*In re* Bayou Grp., L.L.C.), 439 B.R. 284, 309 (S.D.N.Y. 2010) ("Section 548(c)'s good faith affirmative defense is marked by a lack of clarity if not outright confusion. . . . [T]here is little agreement among courts as to what conditions ought to allow a transferee [the good faith] defense.") (alterations in original); Brown v. Third Nat'l Bank (*In re* Sherman), 67 F.3d 1348, 1355 (8th Cir. 1995) ("Good faith is not susceptible of precise definition and is determined on a case-by-case basis."); *In re* Telesphere Commc'ns, Inc., 179 B.R. 544, 557 (Bankr. N.D. Ill. 1994) (noting there is "no clear source of interpretative guidance" in construing good faith and that the courts have "varied widely in the general approach they have taken in deciding questions of good faith in the context of fraudulent conveyance law").

95. Hopkins, *supra* note 94.

96. *See, e.g.*, *In re* Bayou Grp., L.L.C., 439 B.R. at 313; *In re* World Vision Ent., Inc., 275 B.R. at 661; Jobin v. McKay (*In re* M & L Bus. Mach. Co.), 84 F.3d 1330, 1334 (10th Cir. 1996); Hayes v. Palm Seedlings Partners-A (*In re* Agric. Rsch. & Tech. Grp., Inc.), 916 F.2d 528, 539 (9th Cir. 1990).

97. *See In re World Vision Ent., Inc.*, 275 B.R. at 658.

98. *Id.* at 659 (citing *In re* M & L Bus. Mach. Co., 84 F.3d at 1337–39).

99. *See id.*

100. *See id.* at 660 ("[A]s a general rule, before selling the notes, a reasonable broker must review available investment ratings from qualified financial rating services.").

101. *Id.*

the employees in that specific case objectively "did not perform the minimal due diligence steps needed to demonstrate that they acted in good faith."[102]

In re Bayou Group is another case that adhered to the objective good faith inquiry standard.[103] The court noted that the good faith test generally necessitates a two-step inquiry:

> The first question typically posed is whether the transferee had information that put it on inquiry notice that the transferor was insolvent or that the transfer might be made with a fraudulent purpose. . . . Once a transferee has been put on inquiry notice of either the transferor's possible insolvency or of the possibly fraudulent purpose the transfer, the transferee must satisfy a 'diligent investigation' requirement.[104]

The majority approach to evaluating whether inquiry notice is triggered involves "focus[ing] on the circumstances specific to the transfer at issue."[105] For example, a transferee choosing to "remain willfully ignorant of facts which would alert her to the debtor's fraudulent purpose" would suffice as inquiry notice.[106] "An objective, reasonable investor standard applies to both the inquiry notice and the diligent investigation components of the good faith test."[107]

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102. *Id.* at 660.

> Given that good faith is determined using an objective standard and that no reasonable person would have proceeded in a manner similar to the defendants without completing the requisite due diligence, [the defendant's] excuse that 'he didn't know better' merely establishes ignorance, not good faith. No reasonable broker would have sold the debtor's notes based on these defendants' investigation.

Id. at 661. The American Bankruptcy Institute recognizes an interesting problem that this holding creates. The holding puts defendants in the position of having to show that not only did they not know about the debtor's fraudulent purpose, but they must also show that there was no way it could have been discovered through reasonable inquiry. *See* Howard Gorney & Lee Harrington, *The Importance of Good Faith in Fraudulent Transfer Analysis*, AM. BANKR. INST. (Mar. 1, 2003), https://www.abi.org/abi-journal/the-importance-of-good-faith-in-fraudulent-transfer-analysis#12 [https://perma.cc/5PXD-MZTJ]. As the ABI puts it, "[i]n the murky circumstances of a fraudulent transfer action, it might be easier to prove the sun rises in the west." *Id.*

103. *See* Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, L.L.C. (*In re* Bayou Grp., L.L.C.), 439 B.R. 284, 313 (S.D.N.Y. 2010).

104. *Id.* at 310–12. *See also* BLACK'S LAW DICTIONARY (11th ed. 2019) (defining inquiry notice as "[n]otice attributed to a person when the information would lead an ordinarily prudent person to investigate the matter further").

105. *In re Bayou Grp., L.L.C.*, 439 B.R. at 311.

106. *Id.* at 312 (quoting Luzinski v. Gosman (*In re* Gosman), No. 01–30953–BKC–PGH, 2005 Bankr. LEXIS 3183, at *52 (Bankr. S.D. Fla. Mar. 1, 2005)). For example, the specific inquiry notice "red flags" that an objectively reasonable investor would have caught in this case included (1) allegations made in a lawsuit filed against Bayou; (2) Bayou's delay in providing net asset values for Bayou Funds; and (3) negative information concerning Bayou set forth in two background investigation reports. *See id.* at 318.

107. *Id.* at 313.

B. The Subjective Good Faith Inquiry

The subjective good faith inquiry focuses on whether the employee acted reasonably, rather than focusing on routine industry practices.[108] *In re Independent Clearing House* was one of the first courts to hold that the construction of the phrase "in good faith" may depend largely on the facts of the individual case as they develop.[109] The test the court used in this case to determine if the employee was acting "in good faith" was "whether the transaction in question bears the earmarks of an arm's length bargain."[110] Although certain promises might seem suspicious, the court held that "something more" is needed to indicate that the defendants lacked good faith.[111]

More recently, *In re Taneja* also introduced a measure of subjectivity into the good faith inquiry.[112] Taneja operated FMI, a "business [that] engaged in originating home mortgages and selling those loans to investors . . . , who aggregated the mortgage loans and often securitized them for sale to different investors."[113] To create these mortgage loans, "FMI worked with numerous financial institutions known as 'warehouse lenders.'"[114] When the business started to fail, FMI and Taneja began to engage in fraudulent conduct.[115] During this period of fraudulent conduct, First Tennessee Bank became one of these warehouse lenders, thus furthering the fraudulent scheme by extending the business a line of credit.[116] Once the business collapsed, the trustee sought to recover nearly four million dollars that FMI transmitted to the bank "on the ground[s] that the funds were conveyed fraudulently."[117] First Tennessee Bank rebutted that it received the payments for value and in good faith, in conformity with 11 U.S.C. § 548(c).[118]

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108. *See* Hopkins, *supra* note 94.

109. *See* Merrill v. Abbott (*In re* Indep. Clearing House Co.), 77 B.R. 843, 861 (Bankr. D. Utah 1987).

110. *Id.* at 862 (citing Bergquist v. First Nat'l Bank (*In re* Am. Lumber Co.), 5 B.R. 470, 477 (D. Minn. 1980)).

111. *See In re Indep. Clearing House Co.*, 77 B.R. at 862. Remember, *In re Independent Clearing House* is a case about Ponzi scheme investors' ability to recover their transfers. The reasoning that "[t]he mere fact that the debtors promised exorbitant returns on a defendant's investment, however, does not, without more, mean that the defendant lacked good faith," must be extrapolated to the context of the employee of a Ponzi scheme. *Id.*

112. *See* Gold v. First Tenn. Bank Nat'l Ass'n (*In re* Taneja), 743 F.3d 423, 430 (4th Cir. 2014).

113. *Id.* at 425.

114. *Id.*

115. *Id.*

116. *See id.* at 426.

117. *Id.* at 427.

118. *See id.*

Although the court determined the test in evaluating good faith to be "'what the transferee [actually] knew or should have known' when it accepted the transfers," the court applied this seemingly objective test in a subjective manner.[119] Instead of adopting a bright line rule that evaluates the bank's actions in line with the objectively reasonable industry standard, the court evaluated whether First Tennessee acted reasonably in this *specific* context.[120] Although the bank's actions might have failed the good faith test in a normal context, the court emphasized the specific context of the 2008 recession changed the transferee's outlook on activities usually indicative of fraud and therefore affirmed the lower courts applied the correct procedure to find that First Tennessee acted reasonably and in good faith.[121] The dissent also indicated that the majority supported the adoption of the subjective good faith test, by highlighting that if the Fourth Circuit was truly applying an objective good faith test, "the proper inquiry should have been whether the facts would have alerted a reasonably prudent warehouse lender to the fraud."[122] Instead, the court allowed First Tennessee to present witnesses that explained why FMI's conduct did not raise suspicions of fraud at First Tennessee.[123]

IV. PROPOSAL

As evinced throughout this Note, in order for an employee of a Ponzi scheme to keep his or her wages under the affirmative good faith defense, the "worker ant" must surmount two conditions delineated in section 548 of the Bankruptcy Code[124] or section 4 of the UFTA.[125] The first obstacle to surmount in pursuing a good faith defense is whether the court decides to adhere to the viewpoint that any service in furtherance of a Ponzi scheme is

119. *Id.* at 430 (alteration in original) (quoting Goldman v. City Cap. Mortg. Corp. (*In re* Nieves), 648 F.3d 232, 238 (4th Cir. 2011).

120. *See In re Taneja*, 743 F.3d at 431.

121. *See id.* at 432–33.

122. *Id.* at 434–38 (Wynn, J., dissenting); Hopkins, *supra* note 94 (explaining that *Taneja* introduced "a measure of subjectivity" into the court's analysis of a transferee's good faith, and highlighting whether other circuits will also introduce this subjective analysis when assessing good faith in the section 548(c) context remains to be seen). *See also In re Tajena*, 743 F.3d at 434–38 (Wynn, J., dissenting).

123. *See In re Taneja*, 743 F.3d at 434. For example, the court allowed a witness to explain that FMI's extreme financial difficulties were not necessarily uncommon in the warehouse lending industry during 2007 and 2008. *See id.* Because of the market's declining conditions, First Tennessee was not suspicious of FMI's failure to sell many of its mortgage loans and therefore did not investigate for fraud. *See id.*

124. 11 U.S.C. § 548(a)(1).

125. UNIF. FRAUDULENT TRANSFER ACT §§ 4, 8 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 1984).

per se valueless,[126] or whether the court instead chooses to evaluate value on a case-by-case basis, moving to an evaluation of the individual employee's good faith.[127] This split in opinion should be resolved by adopting the latter viewpoint and refraining from merely stating that the employee is hapless based on the inherent nature of a Ponzi scheme. The main reasons that courts choose the "per se no value" route are as follows: first, any employment contract within a Ponzi scheme is in furtherance of an illegal scheme, thereby making it an illegal contract and unenforceable.[128] Second, homing in on a policy rationale, any labor in furtherance of the Ponzi scheme simply exacerbates harm to the defrauded creditors.[129]

Addressing each of these arguments in turn, the Latin maxim, *in pari delicto potior est conditio defendentis*, asserts "the general principle that a plaintiff has no standing in court to seek restitution . . . [regarding] an illegal transaction."[130] However, an exception exists where one party is "unaware of the illegality of the transaction."[131] In cases where one party was ignorant of a fact that rendered the contract illegal, he or she is able to recover in restitution.[132] In order to utilize this exception in the realm of contract law, one would need to proceed to an evaluation of good faith,[133] which can only occur if the court concludes that Ponzi schemes are not per se valueless.

126. *See supra* Section III.A.

127. *See supra* Section III.B.

128. *See, e.g.*, Floyd v. Dunson (*In re* Ramirez Rodriguez), 209 B.R. 424, 434 (Bankr. S.D. Tex. 1997) (stating that "[a]s a matter of law, the defendant gave no value to the [Ponzi scheme operators] for the commissions attributable to investments made by others pursuant to the verbal agreement with [the debtors]"); Martino v. Edison Worldwide Cap. (*In re* Randy), 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995) ("Generally, courts will not enforce an illegal contract based upon the 'elementary principle that one who has himself participated in a violation of law cannot be permitted to assert in a court of justice any right founded upon, growing upon, or out of the illegal transaction.'") (citation omitted).

129. *See, e.g.*, Warfield v. Byron, 436 F.3d 551, 560 (5th Cir. 2006) (stating that "[i]t takes cheek to contend that in exchange for the payments he received, the . . . Ponzi scheme benefited from his efforts to extend the fraud by securing new investments"). The court in *Warfield* further explained that another case held "investors who talked up Ponzi scheme, even if they had a contract, conferred no value since enforcing an illegal contract exacerbates harm to defrauded creditors." *Id.* (citing Dicello v. Jenkins (*In re* Int'l Loan Network, Inc.), 160 B.R. 1, 16 (Bankr. D.D.C. 1993)).

130. John W. Wade, *Restitution of Benefits Acquired Through Illegal Transactions*, 95 U. PA. L. REV. 261, 261 (1947). The Latin maxim's direct translation is "when the parties are equally at fault, the defendant's position is more compelling." In Pari Delicto Potior est Condicio Defendentis Latin Translation, OXFORD REFERENCE, https://www.oxfordreference.com/view/10.1093/acref/9780195369380.001.0001/acref-9780195369380-e-962 [https://perma.cc/XR6Z-97C6].

131. Wade, *supra* note 130, at 265.

132. *See id.* at 265–66.

133. *See, e.g.*, *id.* at 267–68 ("If the decision actually turns upon the plaintiff's innocence, the problem is apparently one of fact which should be submitted to the jury.").

As for the second argument, that any service in furtherance of a Ponzi scheme simply exacerbates the scheme,[134] it is undeniable that the contention has merit. For example, the Chinese celebrities and political figures in the Yilishen Tianxi Group scheme vouching for the product's alleged effectiveness clearly made the product more attractive to the population and more profitable for the farmers looking to invest.[135] Therefore, these individuals did exacerbate the Ponzi scheme. However, is it not also inarguable that each investor exacerbated the scheme?[136] Which party seems more culpable—the politician or celebrity, who undertook commercial/advertising work at an average market price, or the ant farmer, who invested in a scheme premised on feeding ants cake, blinded by the prospect of an unbelievable thirty percent return? Case law illustrates that investors can recover their principal investment (without any profits) in restitution.[137] Are employees acting in legitimate good faith any more or less culpable than an investor? The employees of Ponzi schemes who are acting in good faith exchange their time and services at an agreed-upon rate, thus entitling them to the opportunity to prove their good faith and secure restitution, rather than automatically forfeiting these profits to the arguably equally culpable investor.

The second obstacle to overcome is wading through the nebulous and undefined good faith standard.[138] Each court seems to adopt a different approach to the definition of good faith, thus promoting inconsistency and confusion. Instead of the varying subjective, objective, and mixture of both standards that have emerged from different courts, employees and service providers should be grouped into three categories: (1) those that were very tangentially involved with the Ponzi scheme operator, (2) those at a high level of employment status within the Ponzi scheme structure, and (3) those employees in between the two aforementioned categories.

The first category includes employees and service providers such as landlords, utility company employees, and clerical/custodial employees. For example, in the ant farmer Ponzi scheme, the Yilishen company headquarters were located in a building in Shenyang.[139] Assuming this building was owned by a commercial property owner, he or she would be very tangentially involved in bolstering the Ponzi scheme's operations by

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134. *See supra* Part III.A.

135. *See supra* Part I.

136. *See In re* Taubman, 160 B.R. 964, 981 (Bankr. S.D. Ohio 1993). The *Taubman* Court noted that "[a]n investor in a [P]onzi scheme is not only a victim but at the same time is a perpetrator." *Id.*

137. *See supra* note 14 and accompanying text.

138. *See supra* Part IV.

139. *See* Kennedy, *supra* note 11.

supplying a place to operate the scheme. Examples of an employee in the second category, those at a high level of the company, would be the chief executive officer, the chief financial officer, the director of compliance, the director of operations, and various other board members. The final category is the most difficult to define and includes employees such as the brokers, the bank operators that unknowingly financed the scheme, advertisers, accountants, and attorneys. In the ant farm example, the Yilishen company employed China's tallest man, Bao Xishun,[140] as well as one of China's prominent comedians, Zhao Benshan, to advertise the effectiveness of the aphrodisiac.[141] Both of these actors in the scheme would be considered category three employees because of their responsibilities to adhere to truthful advertising standards. Additionally, the Chinese government distributed a marketing license to the group, thus giving them an air of legitimacy.[142] These individuals are not necessarily as tangentially involved as a landlord, but they certainly should not be held to the same standard as a CEO.

Generally, courts have little trouble concluding that the employees within category one should be evaluated under a subjective, lenient good faith standard.[143] For example, a plethora of cases[144] cite to the following passage from *In re Universal Clearing House*:

> The debtors' landlord, salaried employees, accountants and attorneys, and utility companies that provided services to the debtors all assisted the debtors in the furtherance of their fraudulent scheme. In spite of this fact, we do not think that the goods and services that these persons and entities provided were without value . . . .[145]

140. *Bao Xishun: World's Tallest Man*, S. CHINA MORNING POST (Jan. 29, 2009, 4:00 PM), https://www.scmp.com/magazines/hk-magazine/article/2030913/bao-xishun-worlds-tallest-man [https://perma.cc/SYC7-KJNC] ("Recognized by the Guinness Book of Records as the world's tallest man, Bao Xishun stands at a whopping 7 feet, 8.95 inches.").

141. *See* Lindsey Hilsum, *[Channel 4 News] Chinese Ant Farmers Left with Crumbs*, YOUTUBE (Feb. 22, 2008), https://www.youtube.com/watch?v=fozHJwtinmM [https://perma.cc/EDT4-ZUHR]; Mark Magnier, *Ants Lead to a Trail of Risky Investments*, L.A. TIMES (Jan. 12, 2008), https://www.latimes.com/archives/la-xpm-2008-jan-12-fg-ants12-story.html [https://perma.cc/HVJ6-EK66].

142. *See* Hilsum, *supra* note 141.

143. *See, e.g.*, Merrill v. Abbott (*In re* Indep. Clearing House Co.), 77 B.R. 843, 861 (Bankr. D. Utah 1987).

144. *See, e.g.*, Orlick v. Kozyak (*In re* Fin. Federated Title & Tr., Inc.), 309 F.3d 1325, 1332 (11th Cir. 2002); Churchill Mortg. Inv. Corp. v. Sixty-Five Brokers (*In re* Churchill Mortg. Inv. Corp.), 256 B.R. 664, 681 (Bankr. S.D.N.Y. 2000); Windham v. Allen, No. 2:18-cv-00054-JNP, 2020 WL 6743268, at *4 (D. Utah Nov. 17, 2020).

145. Merrill v. Allen (*In re* Universal Clearing House Co.), 60 B.R. 985, 999 (Bankr. D. Utah 1986).

Courts tend to agree that the employees contained within this first category can demonstrate their good faith "with relative ease"[146] and should only face a subjective, lenient good faith standard.[147] For example, unless the landlord of the Yilishen Tianxi company headquarters had provable, explicit knowledge of the Ponzi scheme and was acting to further the fraud, the landlord should retain the rent payments from the leased space and not be subject to the avoidance actions.[148]

In stark contrast, the second category of employees should be evaluated under an objective, strict good faith test with a high duty of investigation. As in *In re World Vision Entertainment*, the court must determine the investigatory steps a prudent individual serving in the capacity of the employee in question would take before undertaking his or her paid duties.[149] Whether an individual employee should be "on inquiry notice is [governed] by the standards, norms, practices, sophistication, and experience generally possessed by participants in the transferee's industry."[150] The parties can seek to prove this duty through the use of third-party expert witnesses;[151] however, doing so in a manner that exculpates such a high ranking official in category two would be nearly impossible. The infamous Bernie Madoff Ponzi scheme can best illustrate the unlikelihood that an employee in category two could ever walk away with clean hands.[152] For example, one of the roles of a Chief Financial Officer (CFO) is to manage a ledger or a roster of transaction records.[153] The skills typically sought for a high-level position like CFO frequently include experience in other senior roles; Certified Public Accountant designation; a Master's degree in accounting, finance, or business; and skilled computer

146. Cuthill v. Greenmark, L.L.C. (*In re* World Vision Ent., Inc.), 275 B.R. 641, 658–59 (Bankr. M.D. Fla. 2002) ("Other recipients, such as third party vendors and landlords, probably can demonstrate good faith with relative ease. These types of recipients only deliver goods or rent buildings and have no reason and, more importantly, no duty to inquire into the nature of the debtor's business.").

147. See Mallory A. Sullivan, *When the Bezzle Bursts: Restitutionary Distribution of Assets After Ponzi Schemes Enter Bankruptcy*, 68 WASH. & LEE L. REV. 1589 (2011), for an argument that Congress should be the body to enact any Bankruptcy Code changes.

148. *See In re World Vision Ent.*, 275 B.R., at 658.

149. *See id.* at 659.

150. Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, L.L.C. (*In re* Bayou Grp., L.L.C.), 439 B.R. 284, 313 (S.D.N.Y. 2010).

151. *See, e.g.*, Gold v. First Tenn. Bank Nat'l Ass'n (*In re* Taneja), 743 F.3d 423, 431 (4th Cir. 2014).

152. See Amy Sepinwall, *Righting Others' Wrongs: A Critical Look at Clawbacks in Madoff-Type Ponzi Schemes and Other Frauds*, 78 BROOK. L. REV. 1, 10–13 (2012), for a factual and legal background synopsis of the Madoff scandal.

153. *See* Diana B. Henriques, *Bernie Madoff's Essential Man*, N.Y. TIMES MAG. (May 15, 2015), https://www.nytimes.com/2015/05/14/magazine/bernie-madoffs-essential-man.html [https://perma.cc/U47G-87H5].

application familiarity.[154] Madoff's qualified CFO was Frank DiPascali Jr., and despite starting a job at Madoff's Wall Street office with eager, benevolent intentions, his training and expertise quickly allowed him to realize that the transactions surrounding the money managed for Madoff's wealthy private clients were not legitimate dealings.[155] Instead of quitting the job and reporting Madoff, DiPascali solved the problems Madoff was facing in operating his ingenious Ponzi scheme "by using software to distribute the fake trades in just the right proportion across what soon became several thousand accounts" to help legitimize the fraud.[156]

Interestingly, Wang Fengyou, chairman of the Yilishen Tianxi scheme, allegedly paid his highest company executives to stage protests outside of government offices after the scheme collapsed in 2007.[157] Although the purpose behind Fengyou inciting the masses through his executive board was never reported and remains unclear, the executives' willing participation in the organization of the protests would certainly show the objective lack of good faith, as the standards and norms in the executive tier of employees would prohibit inciting a riot.[158]

The former two categories are relatively predictable in their application; employees in category one will almost always pass the good faith test, and employees in category two will almost always fail the good faith test's requirements. The third category of employees requires a mixture of the lenient subjective and the strictly objective good faith tests, such as the test delineated in *In re Taneja*.[159] By declining to adopt a singular, bright-line rule requiring evidence that the employee's every action concerning the relevant transfers was objectively reasonable in light of industry standards (the test for category two), the court utilizes the industry standards to establish context to evaluate what the transferee knew or should have known.[160] Therefore, the first step of the good faith test for employees in the murky third category should be to present witness testimony and evidence

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154. *See Job Seekers CFO Description*, JOSEPH MICHAELS INT'L, https://josephmichaels.com/job-seekers/cfo-description/ [https://perma.cc/5FTG-26AF].

155. *See* Henriques, *supra* note 153.

156. *Id.*

157. *See Sting in the Tail for China Ant Aphrodisiac Scheme*, *supra* note 7.

158. Some articles hint that the protests were a form of counter-protest to mitigate the ant farmers' protests demanding their money be returned, but no source I found is conclusive on this rationale. *See, e.g.*, *id.*

159. *See* Gold v. First Tenn. Bank Nat'l Ass'n (*In re* Taneja), 743 F.3d 423, 431 (4th Cir. 2014).

160. *See id.* at 431.

to establish industry standard context for the good faith inquiry.[161] Although employees in this third category do not have a duty to investigate, as those in the second category do, they should be responsible for recognizing red flags in their specific industries. These red flags could be delineated and explained by the witnesses establishing the industry standards. The second, more subjective step of the good faith test for category three employees should be the opportunity to explain their reasons why the company's or president's conduct did not raise indications of fraud.[162] Not only will this two-step test give those employees—who perhaps deserve restitution to an even higher degree than the investors—an opportunity to explain their specific work circumstances for the fraudulently operating business, but it will also give a valuable opportunity for the creditor to cross-examine and probe this reasoning based on the industry standards.

The most common employees to fall into this third category are lender banks[163] and independent brokers.[164] Because the courts have been unable to apply a consistent formulaic test to evaluate the good faith of these employees,[165] it is useful to outline this Note's proposed framework's functionality in relation to these moderately involved employees of fraudulent schemes. First, the court record should be replete with evidence of industry standards and practices within these professional occupations.

161. *See id.* Unlike in the second category of employees, this evidence and testimony need not be as formal as strictly third-party expert testimony.

> Although certain cases may warrant, or even require, such specialized testimony, an inflexible rule that expert testimony must be presented in every case to prove a good-faith defense unreasonably would restrict the presentation of a defense that ordinarily is based on the facts and circumstances of each case and on a particular witness' knowledge of the significance of such evidence.

Id.

162. For example, in *In re Taneja*, the parties in question were warehouse lenders. *Id.* at 426. The bank's executive vice president of mortgage warehouse lending, Robert Garrett, and the bank's vice president and relationship manager of the bank's warehouse lending group, Benjamin Daugherty, were tasked with clearing the fraudulently operating company's line of credit. *See id.* The court allowed Garrett and Daugherty the opportunity to explain their reasons why the fraudulent operating company's conduct did not raise indications of fraud despite the company's failure to sell its "mortgage loans in the secondary market in a timely manner," which would normally be indicative to a reasonable warehouse lender of potentially fraudulent practices. *Id.* at 431–32. Their reasons included the stock market crash of 2008, which affected the usual industry conditions under which the two experienced executives were operating. *See id.* at 432. The court ultimately concluded that the evidence from the two lenders' specific circumstances and testimony was sufficient to conclude that the bank accepted the relevant transfers from the fraudulently operating company "in good faith and without knowledge of facts that should have alerted the bank that the transfers were part of a fraudulent scheme." *Id.* at 434.

163. *See supra* note 162 and accompanying text.

164. *See, e.g.*, Warfield v. Byron, 436 F.3d 551 (5th Cir. 2006).

165. Note that some courts did not even surpass the step that determines whether the services offered in furtherance of the Ponzi scheme had value. *See, e.g.*, *Warfield*, 436 F.3d at 552. The test outlined in this Note, therefore, proceeds beyond the value step at which many courts stop, and instead scrutinizes these employees' good faith.

As mentioned, expert testimony is not necessary, but these two occupations involve specialized standards and duties towards clientele that may best be credibly explained through experts in the industry. *In re World Vision Entertainment* explained "the steps a prudent broker acting in good faith would take before selling the debtor's notes" involve investigating the legitimacy of the notes, but the exact investigation may vary from case to case.[166] Some of these minimal steps should include reviewing available investment ratings from qualified financial rating services, looking over audited financial statements of the company, and reviewing literature provided by the company discussing its sales history.[167] Subsequently, the broker should have the opportunity to explain the steps taken within the particular circumstances of the situation, and the reasons he or she concluded the investigation with the belief that there was no fraudulent purpose.[168] The combination of these two steps will allow the court to assess whether a diligent inquiry was made into any suspicious circumstances by the broker, and whether the good faith inquiry was surmounted.

As applied to the ant farmer Ponzi scheme, an advertising service would fall into this third category, and Bao Xishun, China's tallest man, served to further the purposes of the Yilishen Taxani scheme by promoting the product in various commercials.[169] American influencers and endorsers operate under the standards of the Federal Trade Commission: "Endorsements must reflect the honest opinions, findings, beliefs, or experience of the endorser. Furthermore, an endorsement may not convey any express or implied representation that would be deceptive if made directly by the advertiser."[170] This objective industry standard would first

166. Cuthill v. Greenmark, L.L.C. (*In re* World Vision Ent., Inc.), 275 B.R. 641, 659 (Bankr. M.D. Fla. 2002).

167. *See id.*

168. *See, e.g.*, Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, L.L.C. (*In re* Bayou Grp., L.L.C.), 439 B.R. 284 (S.D.N.Y. 2010) (holding broker-dealers and hedge fund advisors in these specific circumstances could have reasonably concluded that there was no fraudulent activity occurring and reversing the lower court to proceed to trial). One of these specific circumstances that the court ruled could not constitute the lack of good faith as a matter of law involved a disgruntled employee from the fraudulently operating company who alleged causes of action for breach of contract, infliction of emotional distress, and vague references to regulatory violations. *See id.* at 319–21. Although the lower court held that the disgruntled employee's complaint was a call for any broker/investor to ask questions and get answers about company fraud, the bankruptcy court held that the anger stemming from being fired, as well as the vagueness of the complaint, should be considered by the jury in evaluating the good faith of the broker-dealers. *See id.* at 320.

169. *See supra* notes 140–41.

170. 16 C.F.R.§ 255.1(a) (2021). For those interested, some examples of Chinese advertising laws that Xishun could have been subjected to and could therefore serve as industry standards to inform his good faith inquiry include prohibiting the use of superlative expressions and requiring the advertiser to have used the product before endorsing it. *China's New Advertising Law: Harsher Measures to Curb*

be given for context to inform the good faith inquiry. Then, the court should move to hearing Xishun's testimony or other evidence to determine if he adhered to these standards, and if he strayed from following industry standards, his subjective reasoning for doing so. Because the government endorsed the efficacy of the product, both Xishun and the Chinese advertising company would likely survive the good faith inquiry and be able to retain reasonable market value rates for the services performed.[171]

V. POLICY IMPLICATIONS

Because there is no legitimate capital when the façade of a Ponzi scheme shatters, there is a limited pool of money to make the victims whole. However, the "worker ant" who acted in good faith in accordance with section 548[172] should not serve as a source of funds to compensate the harmed investors.

One rationale prompting the recovery of net earnings from investors to compensate those who suffered a net loss is that the Ponzi scheme "winners" were unjustly enriched, since the scheme was fraudulent.[173] The law of unjust enrichment states that "[a] person has a right to have restored to him a benefit gained at his expense by another, if the retention of the benefit by the other would be unjust."[174] Unlike an investor who simply contributes to a different investors net earnings through the cyclical, unsustainable flow of cash, an employee acting in good faith exchanged services at a market price value for his or her wages.

The interplay between the common law of restitution and the statutory law of bankruptcy is understudied and nebulous,[175] but it certainly makes intuitive sense that retaining wages after performing hours of hard work at a fair market price[176] is not tantamount to unjust enrichment. The paramount example of unjust enrichment involves "the mistaken payment of a non-existent debt, such as when *A* forgets that she has already discharged her

the Unregulated Advertising Industry in China, DAXUE CONSULTING (Sept. 10, 2019), https://daxueconsulting.com/know-chinas-advertising-law [https://perma.cc/8JRF-8UZ7].

171. See *supra* note 59 for a discussion of the Golf Channel retaining its market price advertising service wages despite unknowingly promoting a Ponzi scheme. Janvey v. Golf Channel, Inc., 487 S.W.3d 560 (Tex. 2016).

172. 11 U.S.C. § 548.

173. *See* Sepinwall, *supra* note 152, at 10–13.

174. *See* Warren A. Seavey & Austin W. Scott, *Restitution*, 54 L.Q. REV. 29, 32 (1938).

175. *See* Sullivan, *supra* note 147, at 1599. The contemporary treatment of restitution in bankruptcy has become confused and haphazard because the subject is not addressed by the Bankruptcy code.

176. Wages in excess of fair market price would be subject to avoidance, much like profits of an investor are subject to avoidance. *See, e.g.*, *In re* Taubman, 160 B.R. 964, 981 (Bankr. S.D. Ohio 1993).

debt to *B* and pays *B* twice."[177] Clearly, an employee who exchanged services for goods is different. Investors are entitled to recover the principal of their investment in restitution but must relinquish any profits to equitably compensate those who lost money: "[T]o allow any investor to recover promised returns in excess of the original amount invested would be to further the Debtor's fraudulent scheme at the expense of other investors, particularly newer investors."[178] Likewise, an employee should be entitled to the market value of the wages, as his or her good faith exchange of service did not bestow a windfall upon her, and equitable principles of restitution, although uncommonly discussed in the context of bankruptcy law, should govern the definition of value.

Even if one looks at the unknowing investor more sympathetically than the unknowing employee, the three-tier good faith proposal within this Note[179] strikes a compromise between the interests of the two parties. By applying a strict, objective good faith test in the case of category two employees, the investor's pool to recover from includes funds from high-level employees, whose expertise (indubitably exceeding that of even the savviest investor) rarely, if ever, permits recovery. On the other hand, the interest of midlevel and low-level employees in categories one and three are protected with the opportunity to be evaluated within their specific job circumstances.[180]

In addition, the strict good faith scrutiny of high-level, category two employees encourages exit from the fraudulent scheme because of the extremely low likelihood of their ability to satisfy the requirements of an objective section 548(c) test.[181] Midlevel, category three employees are encouraged to take investigating seriously; they will be afforded the opportunity to explain their specific circumstances to a court in an attempt to protect their wages from avoidance, and the best manner of doing so will be diligent investigation on par with industry standards.

Finally, adopting a definition of value that always allows a three-category analysis of the good faith test delineated in section 548(c) would be a significant step in the right direction of promoting consistency, clarity, and equality within the fraudulent transfer context. As the law currently stands, whether an employee will be entitled to his or her wages depends

177. Sepinwall, *supra* note 152, at 35.

178. *In re Taubman*, 160 B.R. at 981. The *Taubman* Court noted that "[a]n investor in a [P]onzi scheme is not only a victim but at the same time is a perpetrator." *Id.*

179. *See supra* Part V.

180. Of course, the midlevel employees are scrutinized to a higher level than lower-level employees to balance the interests of the investors even further. *See supra* Part V.

181. 11 U.S.C. § 548.

entirely on the circuit in which he or she resides; in many circuits, the employee will trailblaze a decision of first impression, since the employee is frequently overshadowed by litigation surrounding the investors. An employee's good faith services are no different than an investor's good faith principal investment. Incorporating these common law restitutionary principles into the courts' framework is imperative to protecting the hard work of the "worker ants."

CONCLUSION

Currently, the "worker ants" of fraudulent conveyance law are infrequently discussed and inconsistently treated by different courts.[182] Despite many employees and service providers of fraudulent schemes contributing time and service to these businesses, many courts end their analysis at the very first question, holding that their hard work inherently has no value. Nevertheless, restitutionary and equitable principles illustrate that the investor can often be just as culpable as the employee, and the most effective solution to redistributing the chaos that ensues upon the collapse of a Ponzi scheme is to surpass this step and continue to the good faith inquiry. Without doing so, employees that have negligible fault in the fraudulent scheme will have not only their livelihood, but also hours of their time stripped away. The three-tiered good faith inquiry approach maintains sight of the importance of compensating blind sighted investors, while also valuing the hard work of lower-level employees.

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182. *See generally supra* Part II.

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