

**An Exercise in Economics: Determining “Value” Under § 548 of the Bankruptcy Code**

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**Introduction**

Determining whether a debtor receives value for a constructively fraudulent prepetition transfer under section 548 of the Bankruptcy Code can prove troublesome when a debtor receives only an indirect, intangible benefit. Section 548 allows a bankruptcy trustee to avoid and recover a debtor's prepetition transfers for which the debtor did not receive “reasonably equivalent value.”<sup>1</sup> However, judicial interpretation of the term “value” has greatly limited the kinds of benefits to the debtor that might qualify.

*Gold v. Marquette (In re Leonard)*<sup>2</sup> both illustrates the limitations that courts have placed on the term “value” for purposes of section 548 and provides insight into the direction in which the law may be moving in this area. In this decision, the United States Bankruptcy Court for the Eastern District of Michigan held that intangible benefits received through a third person can constitute “value” only if they are sufficiently concrete and quantifiable.<sup>3</sup> In so doing, the court

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<sup>1</sup> 11 U.S.C. § 548(a)(1)(B) (2006).

<sup>2</sup> 454 B.R. 444, 457 (Bankr. E.D. Mich. 2011).

<sup>3</sup> *Id.* (finding that the defendant failed to demonstrate that any alleged benefit to Debtors was concrete and quantifiable).

framed the determination of “value” as an economic inquiry. While courts before this decision had previously determined that indirect, intangible benefits received by debtors needed to be economic in nature in order to constitute value, such courts had not rejected the proposition that certain intangible benefits (such as “peace of mind,” for example) might be quantified in terms of economic value.<sup>4</sup> However, the court’s decision in *In re Leonard* has exactly this effect. Because certain intangible benefits inherently cannot be economically quantified, this decision effectively prevents such benefits from constituting value.

Part I of this memorandum discusses section 548 of the Bankruptcy Code’s treatment of constructively fraudulent transfers. Particularly, this section discusses how courts apply section 548 where a debtor receives an indirect, intangible benefit for its prepetition transfer. Parts II and III then discuss how courts determine the value of such indirect, intangible benefits. Specifically, Part II describes when indirect, intangible benefits can constitute value, and Part III describes when they cannot. Finally, Part IV then details the potential impact of *In re Leonard* on courts’ efforts to value indirect, intangible benefits.

## **I. Section 548 of the Bankruptcy Code and the Indirect Benefit Rule**

Section 548 of the Bankruptcy Code allows the trustee to avoid five types of prepetition transfers. Pertinent for our purposes, section 548(a)(1)(B) provides that a “trustee may avoid any transfer . . . of an interest of the debtor in property . . . that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor . . . received less than a reasonably

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<sup>4</sup> See, e.g., *Lisle v. John Wiley & Sons, Inc. (In re Wilkinson)*, 196 F. App’x 337, 342 (6th Cir. 2006) (holding that indirect benefits needed to be “concrete” and “quantifiable”).

equivalent value in exchange for such transfer or obligation.”<sup>5</sup> The Bankruptcy Code does not define the term “reasonably equivalent value.” However, the Code does define “value.” For purposes of the Code’s fraudulent conveyance provision, “value” is defined 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.”<sup>6</sup>

In certain circumstances, the debtor need not receive a direct benefit from the recipient of a prepetition transfer in order to satisfy section 548(a)(1)(B). Typically, the transferee does provide a direct benefit back to the debtor for the transfer.<sup>7</sup> However, if the debtor indirectly benefits via a third party, this indirect benefit might qualify as “value” for purposes of the statute.<sup>8</sup> Such a situation has often been referred to as the “indirect benefit rule.”<sup>9</sup>

The “indirect benefit rule” was first explained by the Second Circuit Court of Appeals in *Rubin v. Manufacturers Hanover Trust*,<sup>10</sup> and is now accepted by a majority of circuits.<sup>11</sup> The debtors in *Rubin* were a collection of affiliated companies in the business of issuing money

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<sup>5</sup> 11 U.S.C. § 548(a)(1)(B).

<sup>6</sup> 11 U.S.C. § 548(d)(2)(A).

<sup>7</sup> See, e.g., *Lisle*, 196 F. App’x at 342 (finding that the benefit to the debtor may be direct).

<sup>8</sup> See, e.g., *id.* (“Value can be in the form of either a direct economic benefit or an indirect economic benefit.”)

<sup>9</sup> See *id.* (“It is well settled that ‘reasonably equivalent value can come from one other than the recipient of the payments, a rule which has become known as the indirect benefit rule.’”) (quoting *In re Northern Merchandise, Inc.*, 371 F.3d 1056, 1058 (9th Cir.2004)) (internal quotation marks omitted).

<sup>10</sup> See *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979 (2d Cir.1981) (explaining the “indirect benefit rule”).

<sup>11</sup> See, e.g., *Mellon Bank, N.A. v. Metro Comm.’s, Inc.*, 945 F.2d 635 (3d Cir. 1991); *In re Jeffrey Bigelow Design Group, Inc.*, 956 F.2d 479 (4th Cir. 1992); *In re Jumer's Castle Lodge, Inc.*, 338 B.R. 344, *aff’d*, 472 F.3d 943 (7th Cir. 2007); *In re Northern Merchandise, Inc.*, 371 F.3d 1056 (9th Cir. 2004); *In re Southern Health Care of Arkansas, Inc.*, 309 B.R. 314 (B.A.P. 8th Cir. 2004).

orders.<sup>12</sup> Because the affiliated enterprise had an unpredictable pattern of liquidity needs, the debtors entered into a credit agreement with Manufacturers Hanover Trust Company (the “Bank”).<sup>13</sup> Pursuant to this agreement, the Bank provided lines of credit at the debtors’ behest to companies that acted as sales agents for the debtors.<sup>14</sup> Each debtor pledged assets (including the balances of checking accounts and various securities) as collateral to the bank in order to induce the bank to issue these lines of credit. When the entire enterprise collapsed, the Bank quickly seized the funds remaining in the debtors’ checking accounts, and sold securities pledged by the debtors as collateral.<sup>15</sup> Soon thereafter, the debtors filed for bankruptcy.<sup>16</sup> The trustees of the debtors’ estates brought claims against the Bank for fraudulent conveyances under section 67(d) of the Bankruptcy Act, which was then in effect.<sup>17</sup> The district court below dismissed the fraudulent transfer claims and entered judgment in favor of Manufacturers Hanover Trust, finding that the trustees did not prove lack of fair consideration.<sup>18</sup> Finding that the district court below failed to “attempt to measure the economic benefit, if any, that accrued to each bankrupt” as a result of the benefit received by the debtors’ sales agents, the Second Circuit vacated the district court’s entry of judgment in favor of Manufacturers Hanover Trust Company.<sup>19</sup> In support of its holding, the court explained,

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<sup>12</sup> *Rubin*, 661 F.2d 979, 980 (2d Cir.1981).

<sup>13</sup> *Id.* at 981.

<sup>14</sup> *Id.* at 991.

<sup>15</sup> *Id.* at 986–87.

<sup>16</sup> *Id.* at 986.

<sup>17</sup> *Id.* at 987. Section 67(d) preceded the now applicable section 548 of the Bankruptcy Code. *Id.* at 988.

<sup>18</sup> *Id.* at 991. The “fair consideration” element under the Bankruptcy Act predates the “reasonably equivalent value” element of section 548 of the Bankruptcy Code. *Id.*

<sup>19</sup> *Rubin*, 661 F.2d at 996.

[A] debtor may sometimes receive “fair” consideration even though the consideration given for his property or obligation goes initially to a third person . . . [T]he transaction's benefit to the debtor need not be direct; it may come indirectly through benefit to a third person . . . . If the consideration given to the third person has ultimately landed in the debtor's hands, or if the giving of the consideration to the third person otherwise confers an economic benefit upon the debtor, then the debtor's net worth has been preserved, and [the statute] has been satisfied-provided, of course, that the value of the benefit received by the debtor approximates the value of the property or obligation he has given up.<sup>20</sup>

The court thus indicated that an indirect benefit received by a debtor must preserve the debtor's economic net worth to qualify as “value.”<sup>21</sup> Courts have placed the burden of proving that the indirect benefit is sufficiently “concrete and quantifiable” on the defendant.<sup>22</sup> Moreover, the defendant has the further burden of actually quantifying the economic value of the debtor.<sup>23</sup> Only if the economic value of the benefit to the debtor equates with the value of the transfer given up (resulting in a zero change in the debtor's net worth) will the defendant be able to escape the trustee's power to avoid and recover the transfer.<sup>24</sup>

The defendant's burden of quantifying an indirect benefit proves particularly troublesome when the indirect benefit is also intangible. Intangible benefits are by their very nature difficult to quantify.<sup>25</sup> Nonetheless, courts have found that certain intangible, indirect benefits (such as

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<sup>20</sup> *Id.* at 991–92.

<sup>21</sup> *Id.*

<sup>22</sup> *Lisle*, 196 F. App'x at 342 (placing the burden on defendant to quantify the indirect, intangible benefit).

<sup>23</sup> *Id.*

<sup>24</sup> *See Rubin*, 661 F.2d at 991–92 (“ If the consideration given to the third person has ultimately landed in the debtor's hands, or if the giving of the consideration to the third person otherwise confers an economic benefit upon the debtor, then the debtor's net worth has been preserved.”).

<sup>25</sup> *See, e.g., In re Fidelity Bond and Mortg. Co.*, 340 B.R. 266, 287 (Bankr.E.D.Pa.2006); *In re Dayton Title Agency, Inc.*, 292 B.R. 857, 875 (Bankr.S.D.Ohio 2003).

“professional goodwill”) can be quantified.<sup>26</sup> Such benefits may constitute value. However, other indirect, intangible benefits (such as “peace of mind”) cannot be quantified, and therefore cannot constitute value.

## II. Certain Indirect, Intangible Benefits May Constitute Value

Certain indirect, intangible benefits may constitute value. For example, the court in *Dayton Title Agency, Inc. v. White Family Cos., Inc. (In re Dayton Title Agency)*,<sup>27</sup> held that professional goodwill and continued business relationships may provide an indirect benefit to a debtor if the debtor could measure or quantify the economic value of the benefit.<sup>28</sup> In *Dayton*, the debtor Dayton Title Agency (“Dayton”) was a title agency that provided closing services on real estate transactions conducted by Krishan Chari, a real estate broker.<sup>29</sup> Some of these transactions involved Chari funneling funds through Dayton’s trust accounts.<sup>30</sup> In 1998, Dayton began to have trouble collecting funds from Chari to cover disbursements made from the trust accounts at Chari’s behest.<sup>31</sup> Specifically at issue in *Dayton* were transactions conducted at Chari’s direction through Dayton’s trust account involving Chari’s real estate investment enterprise, Invesco, LLC.<sup>32</sup> Two entities, White Family Companies and Nelson Wenrick, each provided bridge loans to Invesco in order to facilitate the purchase of commercial real estate.<sup>33</sup>

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<sup>26</sup> See, e.g., *Rubin*, 661 F.2d at 991–92.

<sup>27</sup> 292 B.R. 857, 875 (Bankr. S.D. Ohio 2003) *aff’d in part, rev’d in part sub nom. White Family Companies, Inc. v. Dayton Title Agency, Inc.*, 2012 WL 604290 (S.D. Ohio Feb. 24, 2012).

<sup>28</sup> *Id.* (“[C]ourts should analyze both direct and indirect benefits to a debtor in determining whether reasonably equivalent value has been received.”).

<sup>29</sup> *Id.* at 862.

<sup>30</sup> *Id.* at 862–63.

<sup>31</sup> *Id.* at 863.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

These loans were generally carried out through Dayton's trust accounts.<sup>34</sup> When the White Family Companies and Nelson Wenrick attempted to withdraw funds from Dayton's accounts in repayment of a loan made to Chari, they overdrew the account due to insufficient funds.<sup>35</sup> Although Chari had deposited a check with Dayton's accounts to repay these loans, the check bounced and the account displayed a negative balance after the withdrawals.<sup>36</sup> After Dayton filed for bankruptcy, the bankruptcy trustee sought to avoid and recover the funds withdrawn by the White Family Companies and Nelson Wenrick as a constructively fraudulent conveyance.<sup>37</sup> The bankruptcy court found in favor of Dayton on this claim.<sup>38</sup> In its defense, the White Family Companies argued that it provided Dayton with reasonably equivalent value for the transfers.<sup>39</sup> Namely, the White Family Companies argued that Dayton benefited from professional goodwill and continued business relationships with Chari.<sup>40</sup>

The bankruptcy court acknowledged that the indirect, intangible benefits of professional goodwill and continued business relationships can constitute value as long as they are properly quantified.<sup>41</sup> However, the court held that the White Family Companies failed to properly quantify the value of such benefits in this case:

While goodwill and the continuation of business relationships can be indirect benefits to a business debtor, WFC and Wenrick have not attempted to measure or quantify the economic value of Dayton Title's continued relationship with Chari. Instead, they only speculate, without evidentiary support, that the value of Dayton Title's ongoing relationship with Chari is reasonably equivalent to the \$4,142,151.38 loss experienced by Dayton Title forcing it to close its doors and

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<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 864.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 875.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

seek bankruptcy protection. The court finds this assertion too speculative to merit consideration.<sup>42</sup>

Thus, even though the White Family Companies failed to do so in this case, the court left open the possibility that such intangible benefits as professional goodwill can be quantified.<sup>43</sup> In accordance with this decision, quantifying the economic value of an indirect, intangible benefit proves essential for a party attempting to prove such a benefit provided “value” to the debtor.

### **III. The *In re Leonard* Decision: Indirect, Intangible Benefits that Do Not Constitute Value**

Other types of indirect intangible benefits do not constitute value. The court in *In re Leonard* dealt with such a situation. Its adjudication of the dispute not only clarifies the defendant’s burden in constructively fraudulent transfer cases involving indirect, intangible benefits. The case also illustrates the direction in which courts may be headed in deciding such cases.

The court in *In re Leonard* decided that “peace of mind” and the “future expectation of financial independence” cannot qualify as provide “value” to a debtor for purposes of section 548 of the Bankruptcy Code.<sup>44</sup> In 2008, the debtors in *In re Leonard* paid Marquette University (“Marquette”) \$21,527 to cover the rest of their adult son’s tuition and related expenses for the 2008–2009 academic year.<sup>45</sup> In November, 2008 the debtors filed for bankruptcy under chapter 7 of the Code.<sup>46</sup> The chapter 7 trustee sought to avoid and recover these payments as

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<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *In re Leonard*, 454 B.R. at 457 (“While satisfying such a moral obligation and receiving such “peace of mind” may be very real benefits that are personally quite important to the Debtors, these intangible benefits are not “economic” benefits to the Debtors. Nor are they “concrete” and “quantifiable” benefits. Under *Lisle*, then, such benefits do not qualify as “value” under § 548.”).

<sup>45</sup> *Id.* at 446.

<sup>46</sup> *Id.* at 448.

constructively fraudulent transfers pursuant to section 548(a)(1)(B).<sup>47</sup> Marquette moved for summary judgment on the ground, *inter alia*, that the debtors received reasonably equivalent value for these payments because the debtors received two benefits from such payments: (1) peace of mind in knowing that their son was receiving a quality education, and (2) the expectation that their son would become financially independent from them because of such education.<sup>48</sup> Thus, the debtors received only indirect benefits.<sup>49</sup> The court, rejecting these arguments, held that the college tuition payments could be recovered as constructively fraudulent transfers because the debtors did not receive “value” for pre-petition payments made to Marquette on their adult son’s behalf.<sup>50</sup> “The Debtors having received such benefits did not increase their ‘net worth,’ nor did such benefits increase the Debtors’ assets in any way that could be used to pay their creditors. Rather, Debtors transferred to Marquette \$21,084.00 . . . and they received no economic value in exchange.”<sup>51</sup>

Although it recognized that indirect benefits received through a third person can constitute “value” if they are concrete and quantifiable,<sup>52</sup> the Court determined that the benefits

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<sup>47</sup> *Id.* The trustee also sought to avoid these transfers as constructively fraudulent section 544(b) of the Code and Michigan state law. *See* Mich. Comp. Laws §§ 566.35(1), 566.34(1)(b). These provisions define reasonably equivalent value in the same way. *See, e.g., In re Leonard*, 454 B.R. at 457 n.9 (recognizing that Michigan statute is similar to Bankruptcy Code).

<sup>48</sup> *Id.* at 454–55.

<sup>49</sup> The increase in the son’s future earning potential provided a direct benefit only to the son. Because the parents demonstrated no reason why they would be legally responsible to financially support their adult son, they could not claim they were directly benefitted by relief from having to do so in the future. Further, the court explained that even if the parents had such a legal duty to support their son, it would be pure speculation to determine whether the education would have any effect on their need to do so. *In re Leonard*, 454 B.R. at 457.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 457–58.

<sup>52</sup> *Rubin*, 661 F.2d at 991 (quoting *Klein v. Tabatchnick*, 610 F.2d 1043, 1047 (2d Cir. 1979)); *Lisle*, 196 F. App’x at 342.

received by the debtors in this case were insufficiently concrete and quantifiable to qualify.<sup>53</sup> As such, Marquette did not provide “value” to the debtors.<sup>54</sup>

Understandably, Debtors may have felt a moral obligation to help their son pay for college, which the tuition payments helped satisfy . . . . While satisfying such a moral obligation and receiving such “peace of mind” may be very real benefits that are personally quite important to the Debtors, these intangible benefits are not “economic” benefits to the Debtors. Nor are they “concrete” and “quantifiable” benefits . . . . [S]uch benefits do not qualify as “value” under § 548.<sup>55</sup>

Concluding the analysis, the court found that because the debtors did not receive “value,” they logically could not have received “reasonably equivalent value.”<sup>56</sup> This holding harmonizes with previous case law regarding the indirect benefit rule. The court indicated that if the net worth of debtors receiving indirect benefits does not remain the same (or increase), then the debtors do not receive reasonably equivalent value.<sup>57</sup> Therefore, in order for Marquette to prove that a debtor received reasonably equivalent value, it had to attempt to quantify the effects of the indirect benefits such as “peace of mind” and demonstrate the effect that the benefit had on the debtor’s net worth. Marquette failed to carry its burden.<sup>58</sup> The court indicated that these types of intangible benefits (“peace of mind” and “expectation of financial independence”) can never constitute value because they can never be quantified.

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<sup>53</sup> *In re Leonard*, 454 B.R. at 457.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 457–58.

<sup>58</sup> *Id.* at 459.

#### IV. Implications Arising from the *In re Leonard* Decision

The *In re Leonard* court not only clearly explicated and applied the indirect benefit rule, but also indicated where the law may be heading in this area. Where the debtor receives an indirect intangible benefit, the indirect benefit rule forces defendants to come up with some way of quantifying the economic value of this intangible benefit.<sup>59</sup> However, the result in *In re Leonard* indicates that such an undertaking is often practically impossible. For example, this case points out that attempting to economically quantify “peace of mind” is an inherently futile exercise.<sup>60</sup> In fact, Marquette failed to even attempt to do so.<sup>61</sup> Because it is practically impossible to quantify certain intangible benefits in this way, the court explicitly recognized that this requirement effectively eliminates a wide variety of potential benefits from providing reasonably equivalent value for purposes of section 548 of the Code.<sup>62</sup>

The predictive value of this decision comes from the unambiguous stance its take with regard to intangible benefits. The substance of this holding should surprise no one. After all, as explained above, it is a clear application of the widely accepted indirect benefit rule. However, while courts have previously determined that indirect benefits received by debtors need to be economic in nature in order to constitute value,<sup>63</sup> such courts had not explicitly ruled out the proposition that certain intangible benefits might be quantified in terms of economic value.<sup>64</sup>

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<sup>59</sup> *Lisle*, 196 F. App'x at 342.

<sup>60</sup> *In re Leonard*, 454 B.R. at 457.

<sup>61</sup> *Id.* at 459 (“When questioned during the hearing on the motions about how to value this claimed indirect benefit, Marquette's counsel replied only that it would be an ‘extremely difficult determination.’”).

<sup>62</sup> *Id.* at 459.

<sup>63</sup> *Lisle*, 196 F. App'x at 342.

<sup>64</sup> *Id.*

Nevertheless, the *In re Leonard* court explicitly held that the satisfaction of strictly moral obligations (such as affording one's children important opportunities in life) cannot qualify as "value."<sup>65</sup> The court found that "[s]peculative and unquantifiable claims of psychological benefits" will never satisfy the defendant's burden of demonstrating that the debtor received value.<sup>66</sup> Thus, this decision gives one indication that courts are beginning to recognize the impossibility of a defendant's use of such benefits to defend against a Trustee's action to avoid a constructively fraudulent transfer under section 548.

The court also indicates a potential problem with this trend. The court recognizes that even though intangible benefits such as the satisfaction of moral obligations cannot satisfy the indirect benefit rule because they cannot be concrete and quantifiable, they nonetheless "may be very real benefits that are personally quite important to the Debtors."<sup>67</sup> However, when one considers that the policy behind the indirect benefit rule and the fraudulent transfer provisions of the Code is to preserve assets for the bankruptcy estate with an eye towards distribution to creditors, this problem largely dissipates.

## **Conclusion**

The decision in *In re Leonard* both illustrates the limitations that courts have placed on the term "value" for purposes of section 548 and provides insight into the direction in which the law may be moving in this area. The widely accepted indirect benefit rule provides that indirect benefits received by debtors in exchange for a prepetition transfer constitute "value" only if they

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<sup>65</sup> *In re Leonard*, 454 B.R. at 459.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 457.

are sufficiently concrete and quantifiable.<sup>68</sup> While courts before the *In re Leonard* decision had previously determined that indirect benefits received by debtors needed to be economic in nature in order to constitute value, such courts had not ruled out the proposition that certain intangible benefits might be quantified in terms of economic value.<sup>69</sup> However, the court's decision in *In re Leonard* had exactly this effect. Because certain intangible benefits inherently cannot be economically quantified, this decision effectively prevents such benefits from constituting value.

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<sup>68</sup> See, e.g., *Rubin*, 661 F.2d 979 (2d Cir.1981).

<sup>69</sup> See, e.g., *Lisle*, 196 F. App'x at 342.

