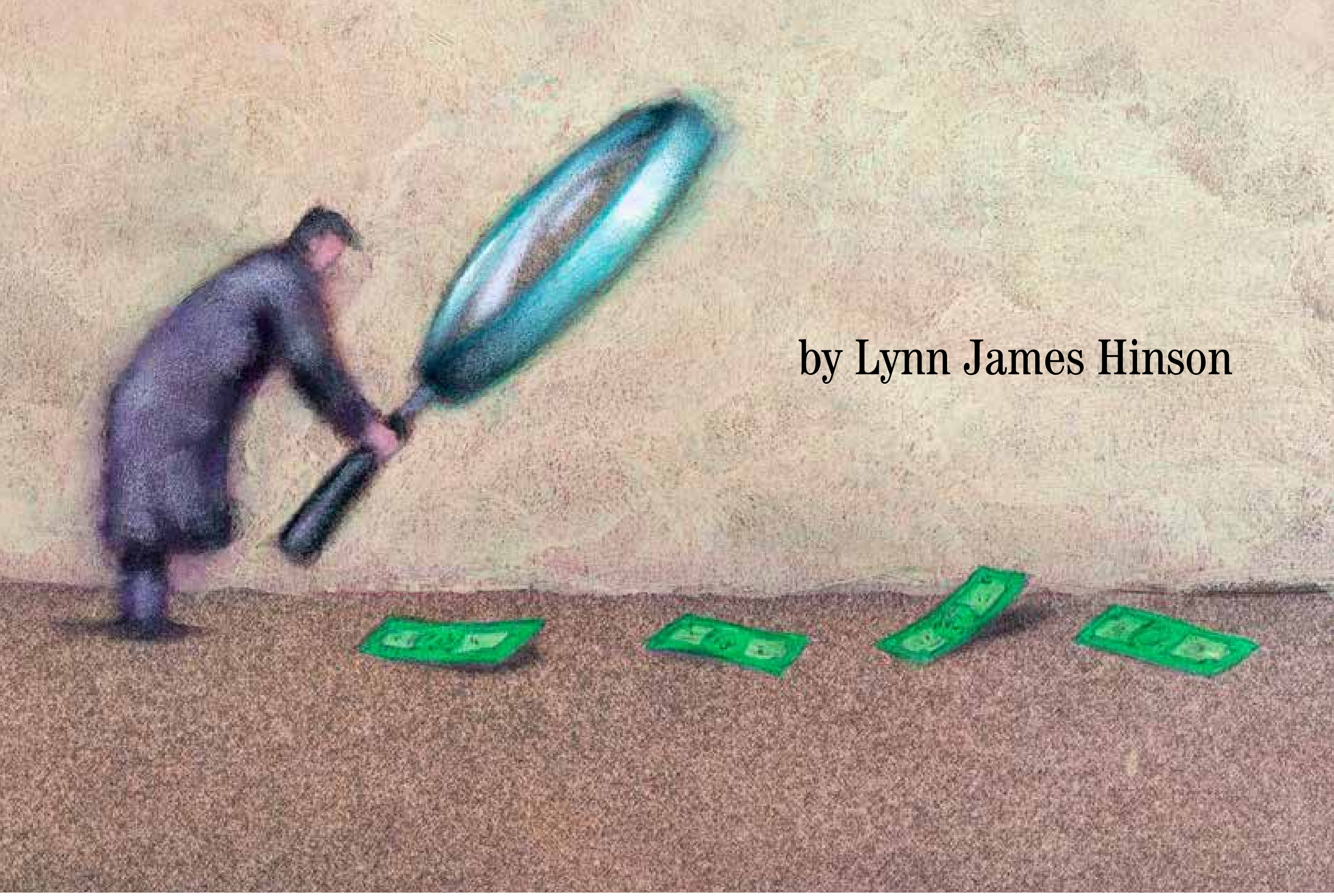
Substantive Consolidation Issues Arising in Ponzi Scheme Bankruptcy Cases



by Lynn James Hinson

In the early 1920s, Charles Ponzi created a scheme (Ponzi's scheme) that enabled him to get very rich. He promised investors unreasonably high rates of return, and used the money of new investors to pay the earlier investors and himself. Inevitably, the scheme collapsed because people stopped investing. Ponzi's name became forever linked to the thousands of Ponzi schemes in which an enormous number of investors have been cheated out of millions, if not billions, of dollars. Creditors and investors are increasingly forcing the perpetrators of the fraud and the entities the perpetrator owns and controls into bankruptcy court. When the individual perpetrator of the scheme and the entities which he owns and controls are forced into bankruptcy, creditors and investors sometime ask the judge to combine all of the separate cases into one. If the judge grants the request, there are major impacts on the bankruptcy trustee's ability to recover money. Before asking the bankruptcy judge to combine the cases, creditors should carefully consider whether they really want what they ask for.

The Original Ponzi Scheme

Charles Ponzi was born in Italy in 1882, and died in Rio de Janeiro in 1949. In 1903, he arrived in Boston. It is believed that Ponzi had as little as $2.50 in cash when he arrived in the United States.

Ponzi's life would have been unremarkable had he not devised a scheme that cheated many investors out of a great deal of money. The scheme started innocently and strategically, involving the purchase of international reply coupons, which could be purchased in one country and redeemed for postage stamps in another country.

He originally purchased international reply coupons through agents outside of the United States. The agents sent the coupons to the United States, and Ponzi exchanged them for stamps that were worth more than he paid for the coupons. He then sold the stamps and kept the profit. At this point his business simply resembled any other business where a commodity was purchased for one price and sold for a higher one, except it involved trading in coupons and stamps before realization of profits in the form of cash.

It did not take Ponzi long to realize that he could make far more money by soliciting others to invest in the business turned scheme. In order to entice investors, he promised them outrageous returns of as much as 100 percent in three months. It is believed that more than $10 million was invested during several months in 1920.

There were no profits generated by the scheme. Instead, investors were being paid with the money of newer investors. Ponzi kept much of the investors' money for himself. The scheme collapsed following an investigation into the "profits" that never existed. After the investors learned of the investigation, they made a run on the company that was owned by Ponzi in an attempt to recoup their investments, but it was too late. "Ponzi's Scheme," as it was known, left most if not all of the investors unable to recover their money.

Ponzi was arrested on August 12, 1920. At the time, he owed investors an estimated $7 million. He pleaded guilty to crimes involving the scheme and spent about 14 years in prison. His wife divorced him, and he died penniless in a foreign country.

The only thing Ponzi left behind was his name, which has been associated with hundreds, if not thousands, of similar schemes which rely on the money of new investors to pay older investors. The common thread among schemes such as these is the promise of unreasonably high rates of return, the absence of any legitimate business and the use of newer investors' money to give the illusion of profitability. Such schemes have become known and widely referred to as "Ponzi schemes."

Despite the old adage that "if it is too good to be true, then it probably isn't true," Ponzi schemes have continued unabated for the past 92 years. The largest Ponzi scheme in history was perpetrated by Bernard L. Madoff, who is serving 150 years in federal prison. It is estimated that investors lost more than $17 billion dollars, although investors have recently received significant distributions.

The Madoff Ponzi Scheme

The massive fraud that was perpetrated by Bernie Madoff is the largest Ponzi scheme in U.S. history. The scheme is described in detail in *In re Bernard L. Madoff Investment Securities LLC*. Although it was far more sophisticated and involved many billions of dollars more than the scheme Charles Ponzi devised, the essence was the same.

Investors were induced to invest billions of dollars based on promises of unrealistic returns on their investments. When customers invested in Bernard L. Madoff Investment Securities LLC, they relinquished all investment authority to Madoff. Madoff collected funds from investors, claiming to invest their funds in a "split-strike conversion strategy" for producing consistently high rates of return on investments. The split-strike conversion strategy supposedly involved buying a basket of stocks listed on the Standard & Poor's 100 Index and hedging through the use of options.

Despite the promises and allure of high returns and quick riches, the collected funds were never invested. Instead, Madoff generated fictitious paper account statements and trading records in order to conceal the fact that he engaged in no trading activity whatsoever. As stated by the U.S. Court of Appeals for the Second Circuit in *In re Bernard L. Madoff Investment Securities LLC*, the investor statements documented an "astonishing pattern of continuously profitable trades," approximating the profits that Madoff had promised his customers, but reflected trades that never occurred.

The investigation into Madoff's activities also revealed many occurrences where purported trades were outside the actual price range for the purported trade dates listed on the customer's fictitious monthly account statements—red flags ignored by the trusting investors.

As is true of all Ponzi schemes, Madoff used the investments of new customers to fund withdrawals of principal and supposed profits made by earlier investors. He, like many other perpetrators of Ponzi schemes, acquired an enormous amount of property and lived exceedingly well on the investors' money.

Madoff's scheme collapsed when the flow of new investors could no longer support the payments required on earlier invested funds. The final customer statements falsely recorded nearly $64.8 billion of net investment and related fictitious gains.

When Madoff's unprecedented fraud was discovered, the Securities and Exchange Commission filed a civil complaint in the U.S. District Court for the Southern District of New York alleging that Madoff and Bernard L. Madoff Investment Securities LLC were operating a Ponzi scheme. The Securities Investor Protection Corporation filed an application seeking a decree that the customers of Bernard L. Madoff Investment Securities LLC were in need of the protections afforded by the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa et seq.

The district court appointed Irving H. Picard as trustee for the liquidation of the business of Bernard L. Madoff Investment Securities LLC. Pursuant to the Securities Investor Protection Act, Picard has the general powers of a bankruptcy trustee, as well as additional powers and duties related to recovering and distributing customer property. Essentially, Picard was charged with the enormous task of unraveling decades of fraud.

Following the appointment of Picard as trustee for the liquidation of the business of Bernard L. Madoff Investment Securities LLC, the Securities Investor Protection Act liquidation was removed to the U.S. Bankruptcy Court for the Southern District of New York.

The Legal Definition of a Ponzi Scheme

A number of courts have articulated the legal definition of a Ponzi scheme. For instance, in *Hirsch v. Arthur Andersen & Co.*, the Second Circuit described a Ponzi scheme as:

> A scheme whereby a corporation operates and continues to operate at a loss. The corporation gives the appearance of being profitable by obtaining new investors and using those

> investments to pay for the high premiums promised to earlier investors. The effect of such a scheme is to put the corporation farther and farther into debt by incurring more and more liability and to give the corporation the false appearance of profitability in order to obtain new investors.

In *Securities and Exchange Commission v. Credit Bancorp, Ltd.*, the court stated that it is in the nature of a Ponzi scheme that customer returns are generated not from legitimate business activity but, rather, through the influx of resources from fresh capital invested by unwitting newcomers.

Recovery of Money in Ponzi Scheme Bankruptcy Cases

There are few practical remedies outside of bankruptcy that will enable creditors and investors to recover even a small percentage of what they are owed in Ponzi schemes. It has therefore become increasingly common for creditors to file involuntary bankruptcy petitions against the perpetrators of such schemes. Bankruptcy judges are quick to appoint bankruptcy trustees in such cases because the U.S. Bankruptcy Code grants trustees powerful remedies for the recovery of money and property for the benefit of the bankruptcy estate.

Bankruptcy trustees appointed in Ponzi scheme cases frequently file numerous adversary proceedings, which are similar to lawsuits filed in other courts, in an effort to recover money and property for the estate. Money and property which is recovered for the estate is used to pay secured and unsecured creditors, the bankruptcy trustee and its attorneys, lawyers for the creditors committee, other professionals approved by the court, and investors.

Defendants in adversary proceedings generally include perpetrators of the Ponzi scheme, entities owned and controlled by the perpetrators, brokers that receive commissions for successfully soliciting investors, service providers, lawyers, accountants, and others. Bankruptcy trustees have sometimes sued banks to recover repayments on loans that were made to the perpetrators of Ponzi schemes and the so-called businesses that they own or control. Trustees have even sued churches and colleges in an effort to recover money for the estate.

Causes of Action Asserted by Bankruptcy Trustees in Ponzi Scheme Cases

Causes of action asserted by bankruptcy trustees in adversary proceedings that arise out of Ponzi schemes invariably include claims that the defendants are recipients of fraudulent transfers. In virtually every case, trustees allege that the defendant was the recipient of a constructively fraudulent transfer or, in the alternative, the recipient of a transfer based on actual fraud, or both.

Section 548(a)(1)(A) of the Bankruptcy Code provides that a trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within two years before the date that the petition is filed, if the debtor voluntarily or involuntarily made the transfer or incurred the obligation with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that the transfer was made or the obligation was incurred.

The intent of the *recipient* of a transfer under § 548(a)(1)(A) need not be fraudulent. Rather, it is the fraudulent intent of the *debtor* that makes the transfer avoidable. Section 548(a)(1)(B)(i) and (ii)(I) provide that a trustee may avoid any transfer of an interest

Recent Ponzi Schemes in the Midwest

Thomas J. Petters, once a prominent Minnesota businessman whose holdings included Polaroid Corporation and Sun Country Airlines, was convicted in 2009 of 20 counts of wire fraud, mail fraud, money laundering, and conspiracy. Petters is currently serving a 50-year prison sentence in Leavenworth, Kansas.

Petters' convictions stemmed from a $3.65 billion Ponzi scheme conducted over many years involving, in large part, the purported purchase of nonexistent consumer electronic products and equipment supposedly secured by fabricated purchase orders from "big box" retailers such as Costco, Sam's Club, and B.J.'s Wholesale Club. Petters and his associates prepared and used fabricated and forged documents to recruit investors in the Ponzi scheme. While the fabricated or forged purchase orders and related documents identified certain inventory, in most cases no such inventory actually existed. The result was that investors were not paid with the earnings from the purported purchases and sales of inventory, but rather with funds raised by Petters and his associates from other investors. Petters also used the money raised from investors to prop up his many other businesses and to fund a lavish lifestyle that included Ferraris, Bentleys, Costa Rican getaways, and multiple residences.

In October 2008, the United States, in support of a criminal investigation, sought and obtained in the U.S. District Court for the District of Minnesota an asset freeze and receivership under the Anti-Fraud Injunction Act, 18 U.S.C. § 1345, against Petters and many of his companies for the benefit of victims of the massive fraud. Shortly thereafter, at the direction of the court-appointed receiver, Douglas Kelley, Petters Company, Inc., Petters Group Worldwide LLC, and several affiliates commenced Chapter 11 bankruptcy cases in Minnesota Bankruptcy Court. Since 2010, the Chapter 11 trustee has commenced more than 200 "clawback" lawsuits against business entities, investors, charities that received donations from Petters, and former employees of Petters' companies who received bonuses—seeking to recover approximately $1.7 billion. Through these lawsuits and negotiated settlements, to date over $300 million has been recovered by the Chapter 11 trustee and over $68 million has been awarded for professional fees and services.

Russell Wasendorf Sr., the chief executive officer of Cedar Falls, Iowa-based Peregrine Financial Group, Inc., ran a nearly 20-year scheme to defraud customers and creditors of of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within two years before the date that the petition is filed if the debtor received less than reasonably equivalent value in exchange for the transfer or obligation incurred *and* was insolvent on the date that the transfer was made or the obligation incurred or became insolvent as a result of the transfer or obligation.

The value received by the *recipient* of a transfer under § 548(a)(1)(B) is not relevant. Rather, it is the value that the *debtor* receives which makes the transfer avoidable if the value received is not reasonably equivalent to the value of the property which was transferred.

Administrative Consolidation

The perpetrators of Ponzi schemes almost invariably include the individual who conceived of and carried out the Ponzi scheme, and various companies, partnerships, limited liability companies, and other entities that are owned or controlled by the individual perpetrator. For instance, the perpetrators of the Madoff scheme included both Bernie Madoff and Bernard L. Madoff Investment Securities LLC.

It is not unusual for separate bankruptcy cases to be filed in the same bankruptcy court by or against the individual who perpetrates the scheme and the entities that the individual owns or controls. When separate cases are filed in the same court, they are invariably consolidated for administrative purposes.

Cases that are consolidated for administrative purposes remain separate. Each case has one debtor with its own assets, liabilities, creditors, equity interest holders, and claims that can be brought by the trustee. The cases are consolidated merely to make administration of the cases more efficient.

Substantive Consolidation

Substantive consolidation is much different than consolidation for administrative purposes. Substantive consolidation has a major impact on the rights of the creditors, the size and scope of the estate, the assets that are available for distribution to creditors and investors, the liabilities of the estate, and the claims that can be asserted by the bankruptcy trustee.

The U.S. Bankruptcy Court for the Northern District of Texas succinctly summarized the effect of substantive consolidation in *In re AHF Development, Ltd*. In that case, the court stated that substantive consolidation results in the combination of two or more debtors into a single pool from which the claims of creditors are paid ratably. The court also stated that the effect of substantive consolidation is the pooling of assets of, and claims against, the consolidated debtors. The legal effect of substantive consolidation was a major issue in *In re Louis J. Pearlman*. The bankruptcy judge in the *Pearlman* case held that the effect of substantive consolidation is that the assets and liabilities of each debtor are consolidated into one estate *for all purposes*.

It was held in *Pearlman* that substantive consolidation is one of the bankruptcy court's equitable powers arising under §§ 105 and 302(b) of the Bankruptcy Code. In the U.S. Court of Appeals for the 11th Circuit, the factors to be considered in deciding whether substantive consolidation is appropriate are:

- The presence or absence of consolidated financial statements;
- The unity of interest and ownership between various corporate entities;
- The existence of parent and inter-corporate guarantees on loans;

the futures and currency brokerage out of approximately $200 million.

Peregrine filed for Chapter 7 bankruptcy protection on July 10, 2012, one day after Wasendorf attempted suicide outside of Peregrine headquarters and left what authorities described as a confession letter revealing his use of a postal box and falsified bank statements to dupe regulators into believing that Peregrine was properly safeguarding customer funds. On the same day, the U.S. Commodity Futures Trading Commission filed a lawsuit in the U.S. District Court for the Northern District of Illinois accusing Peregrine and Wasendorf of fraud, misappropriating customer funds, and making false statements.

In September 2012, Wasendorf pleaded guilty to charges of mail fraud, embezzlement and lying to government regulators. Wasendorf remains in custody as investigators attempt to trace the missing funds. A sentencing date has not yet been set. ⊙

Recent Ponzi Schemes in South Florida

"South Florida has an unfortunate reputation as being the fraud capital of the United States," explained Charles Lichtman of Berger Singerman, P.A., counsel for the court-appointed receiver in the Scott Rothstein fraud. "It's impossible to say why so many sophisticated frauds emanate out of South Florida," he said, but speculated that it is a combination of "weak laws that benefit those who commit financial crimes," the geographical proximity to regions with "either corrupt banks or those that turn a blind eye to enable the laundering of money," and a transient population that can readily be manipulated through fraudulent practices—as he notes, too often victims ignore the adage, "If it's too good to be true, then it's usually not true."

South Florida more than carries its weight in the world of Ponzi schemes. This brief survey of Florida schemes is limited to those at about $1 billion or more, as any lower dollar limit results in too many frauds. The top billion dollar Ponzi schemes with roots in the Sunshine State in recent years include the following:

Scott Rothstein is a South Florida lawyer who used his law firm of Rothstein, Rosenfeldt & Adler to run a $1.2 billion Ponzi scheme involving the sale of bogus structured settlements. In January 2010, Rothstein pled guilty to five federal charges for racketeering, money laundering, and fraud and received a 50-year sentence. The Ponzi scheme has given rise to dozens of lawsuits, generating more than $10 million in fees. Through these lawsuits and many negotiated settlements,

- The degree of difficulty in segregating and ascertaining individual assets and and liabilities;
- The existence of transfers of assets without formal observance of corporate formalities;
- The commingling of assets and business functions;
- The profitability of consolidation at a single physical location;
- The parent owning the majority of the subsidiary's stock; and
- The entities having common officers or directors.

The Legal Effect of Substantive Consolidation on Constructive Fraud Claims

Louis J. Pearlman, who was the founder of The Backstreet Boys, N'Sync and a number of other "boy bands," operated a multimillion dollar Ponzi scheme from his offices in Orlando, Fla. He was able to take advantage of his success in the music business, and the promises of huge returns, to successfully solicit millions of dollars from a large group of investors throughout the United States.

After the Ponzi scheme was discovered and the FBI raided his offices, Pearlman fled the country. He was subsequently captured and returned to Florida to face a large number of federal criminal charges. He ultimately pleaded guilty to numerous criminal charges arising out of the Ponzi scheme, and was sentenced to more than 20 years in federal prison.

On March 1, 2007, an involuntary bankruptcy petition was filed by several banks against Pearlman in the U.S. Bankruptcy Court for the Middle District of Florida. The U.S. bankruptcy judge entered an order granting an emergency motion for the appointment of a bankruptcy trustee shortly after the involuntary case was filed.

Following his appointment, the trustee sought and obtained authority to vote and exercise all rights arising from or related to Pearlman's numerous closely held corporations, limited liability companies, and other business entities. The trustee exercised those rights and caused approximately 10 business entities that were owned or controlled by Pearlman to file bankruptcy. All of the cases were jointly administered and the same trustee was appointed.

The trustee filed a large number of adversary proceedings against banks, vendors, suppliers, service providers, law firms, "net winner" investors and "net loser" investors. The trustee sought to avoid and recover transfers allegedly made by the debtors with actual intent to hinder, delay or defraud their creditors. These claims were brought by the trustee pursuant to § 548(a)(1)(A) of the U.S. Bankruptcy Code and corresponding provisions of the Florida Uniform Fraudulent Transfer Act.

The trustee also sought to avoid and recover transfers that were made by one debtor to pay the obligations of a different debtor, claiming that the transfers were constructively fraudulent. For instance, the trustee asserted in several adversary proceedings that loans made to Pearlman, individually, or one of the Pearlman entities, were repaid, in part, by a different Pearlman entity. These claims of the trustee were based on the contention that the Pearlman entity which repaid a portion of the loan to Pearlman or another Pearlman entity did not receive reasonably equivalent value in exchange for making the loan payments.

Similar claims were made by the trustee against several law firms. The trustee alleged that legal services were rendered to Pearlman or one of the Pearlman entities, but were paid for by another Pearlman entity. The trustee asserted that the Pearlman entity which paid for the legal services did not receive reasonably equivalent value in

the court-appointed receiver has already recovered more than $100 million to date, with additional recoveries likely.

Nevin Shapiro, infamous booster of the University of Miami, ran a Ponzi scheme through his company Capitol Investments USA, which he claimed bought and sold groceries in a $930 million fraud. The various personal uses to which he put investors' monies included: $400,000 worth of Miami Heat tickets, a $1.5 million Riviera yacht, and a pair of diamond-studded handcuffs. More than 70 college athletes allegedly received illegal gifts from Shapiro. In September 2010, he pled guilty to securities fraud and money laundering and was sentenced in June 2011, to 20 years in federal prison.

Steven Steinger and the Ft. Lauderdale-based Mutual Benefits Corporation fraud raised over $1 billion from more than 29,000 investors through securitizing fractionalized interests in viatical and life settlements. A federal receiver was appointed and final judgments entered in 2007, but the fallout continues including in 2011 charges against Steinger and others for obstructing justice and concealing assets.

Allen Stanford ran a $15 billion Ponzi scheme out of a Miami high rise and a bank in Antigua. His office sold $800 million in bogus certificates of deposit, mainly to South American investors. Prosecutors said he used the money from those investors to fund a string of failed businesses, bribe regulators, and pay for a lavish lifestyle that included yachts, a fleet of private jets, and sponsorship of cricket tournaments. Stanford was convicted of 13 of the 14 federal counts and sentenced to 100 years in prison.

And while the infamous fraud by Bernie Madoff was based out of Wall Street, he also kept a home in ritzy Palm Beach, Florida, while running a Ponzi scheme that boasted $65 billion in purported investor assets. In March 12, 2009, Madoff pled guilty to 11 federal felony counts, including securities fraud, money laundering, and perjury and was subsequently sentenced to a term of 150 years. To date, $3.6 billion has been repaid to victims, and more than $9 billion has been recovered so far. Legal fees are deemed likely to exceed $1 billion by 2014. ⊙

exchange for paying fees for services that were not rendered to the debtor that made the payments.

The constructive fraudulent transfer claims were brought pursuant to § 548(a)(1)(B). The trustee referred to these claims as "wrong payor" claims. Faced with the reality that unraveling the adversary proceedings alleging "wrong payor" claims would be extremely difficult and costly, a number of the defendants filed motions for substantive consolidation of all the debtors' estates. The trustee agreed that the estates should be substantively consolidated due to the inextricably interwoven state of the debtors' financial affairs and the costs associated with unwinding what the bankruptcy judge referred to as a "financial mess."

However, the trustee strenuously argued that the court should order only "partial consolidation" in order to preserve the wrong payor claims for the benefit of the unsecured creditors. The trustee also argued that the wrong payor claims were the primary source of recovery for unsecured creditors. Notably, not one creditor supported the trustee's request for partial consolidation in order to preserve the wrong payor claims.

The bankruptcy judge found that the debtors operated substantially as one entity and that the estate would benefit greatly from avoiding the costs associated with the quixotic task of trying to sort out the assets and liabilities of the respective estates. The judge also found that the proponents of substantive consolidation had made a prima facie showing of substantial debtor identity and a significant benefit of consolidation to the estate. However, the judge flatly rejected the trustee's request for partial consolidation. As stated by the judge, the trustee's request for partial consolidation was anathema to the purpose of consolidation.

The judge stated in her ruling that the trustee could not on one hand acknowledge the overwhelming reality that substantive consolidation was warranted, but on the other hand argue for partial consolidation in an attempt to extract additional monies from legitimate creditors who were simply paid for services rendered or debts outstanding from another one of the Pearlman entities. The judge also stated that "[t]he Debtors either were operated as one intertwined entity or they were not. The Trustee cannot have it both ways." Several courts have addressed the circumstances under which partial substantive consolidation may be appropriate. The U.S. Bankruptcy Court for the Central District of California considered the issue in *Gill v. Sierra Pacific Construction, Inc. (In re Parkway Calabasas Ltd.)*. In the *Gill* case, involuntary petitions were filed against related parties. Prior to bankruptcy, one of the debtors made a payment to a contractor that improved property which belonged to another debtor. The trustee sued the contractor, claiming that it had received a constructively fraudulent transfer.

The cases were substantively consolidated, and the trustee argued that the constructively fraudulent transfer claim should be preserved. The bankruptcy judge in *Gill* rejected the trustee's argument, and found that substantive consolidation creates a single case, a single estate, and a single body of creditors. The legal effect of the holding in the *Gill* case is the same as that in the *Pearlman* case.

The bankruptcy judge in *Pearlman* stated the case presented a perfect illustration of why partial consolidation is inappropriate to preserve wrong payor claims. Pearlman ran his Ponzi scheme to deceive his creditors. He created entities with different names, but commingled every entity's assets, monies, and business functions. The judge therefore concluded that Pearlman operated the scheme as one big company and substantive consolidation for all purposes was appropriate.

Substantive consolidation of the cases in *Pearlman* virtually eliminated the wrong payor claims. The assets and liabilities of each debtor were consolidated into one estate for all purposes. Accordingly, the trustee was prohibited from requiring creditors to repay monies that they received from one of the consolidated Pearlman entities simply because they paid the legitimate debt of another consolidated Pearlman entity.

In her ruling, the judge noted that the decision did not automatically extinguish *all* of the trustee's constructive fraud claims. The ruling left open the legal and factual issues that could arise in cases in which a consolidated debtor paid the debt of a non-debtor.

Conclusion

During the past 92 years, investors have been cheated out of their money based on promises of unreasonably high returns and the possibility of quick riches. The schemes, like the one originally perpetrated by Charles Ponzi, rely on the money of new investors to pay older investors. Eventually, there are not enough new investors, and the scheme collapses.

Creditors and investors are increasingly aware that bankruptcy trustees have enormous power to recover money and property for the benefit of the bankruptcy estate. Accordingly, the perpetrators of Ponzi schemes often find themselves in bankruptcy courts, whether voluntarily or involuntarily.

Bankruptcy judges invariably appoint trustees in such cases. Among the powers of a trustee is to file suit against the recipients of transfers made by a debtor with the intent to deceive its creditors.

Trustees also have the power to sue recipients of transfers made by a debtor in exchange for less than reasonably equivalent value. These claims are based on constructive fraud.

Ponzi schemes always involve the individual who conceived of and personally perpetrated the fraud. In most if not all cases, entities owned or controlled by the perpetrator are part of the scheme. When the Ponzi scheme results in voluntary or involuntary bankruptcy, the individual perpetrator and the related entities are often debtors.

Cases such as these are virtually always consolidated for administrative purposes. When the individual perpetrator has commingled money, disregarded corporate formalities, and used the related entities for the purpose of defrauding investors, the creditors or the trustee sometimes seek to have the cases substantively consolidated for all purposes.

The substantive consolidation of debtors results in one case, and all of the assets and liabilities are combined. When substantive consolidation is ordered, wrong payor cases, which involve one debtor paying the debt of another debtor, are no longer viable. However, substantive consolidation does not affect claims based on actual fraud. Those claims survive. ⊙

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