# Ponzi Schemes in Bankruptcy

*J. Gabriel Dennery and Keith J. Larson*

A Ponzi scheme is a basic grift. It "involves a business obtaining money from investors through the promise of a high rate of return on an investment." *Aliera LT, LLC v. Health Reform Team, Inc. (In re Aliera Cos.)*, 665 B.R. 468, *489 n. 15 (Bankr. N.D. Ga. 2024). The business then obtains money from a second set of investors and uses those funds to pay the initial investors. So on and so forth. In many such schemes, this process continues until the business can no longer convince more investors to put money in, so it can't deliver on the promise to the most recent class of investors, resulting in insolvency. These sham businesses often end up in bankruptcy.

In doing so, a Ponzi scheme can open a Pandora's Box of bankruptcy litigation. Bankruptcy trustees in particular may seek to avoid (aka recover) pre-petition transfers in Ponzi scheme chapter 7 bankruptcy cases. A trustee can usually proceed under two distinct theories of recovery: (1) actual fraud, and (2) constructive fraud. 11 U.S.C. § 548; *see, e.g., Kirkland v. Rund (In re EPD Inv. Co., LLC)*, 114 F.4th 1148, 1157 (9th Cir. 2024). Actual fraud claims address the debtor's fraudulent intent, whereas constructive fraud focuses on the lack of reasonably equivalent value exchanged. *Id.*

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### Actual Fraud

To establish intent for actual fraud, trustees routinely rely on the judicially created and "long-standing Ponzi-scheme presumption, which recognizes that a debtor's actual intent to hinder, delay, or defraud its creditors may be inferred by the mere existence of a Ponzi scheme." Kirkland, 114 F.4th at 1152. Some courts have found that if the trustee proves that the debtor operated a Ponzi scheme, the trustee is entitled to a presumption that the transfers were made with actual fraudulent intent. For example, where a bankruptcy court previously determined that debtors operated a Ponzi scheme, commission payments made to an outside broker recruiting new investors were held avoidable as actual fraudulent transfers under 11 U.S.C. § 548(a)(1)(A), regardless of whether the broker knew she was participating in a fraudulent scheme. *In re Woodbridge Grp. of Cos., LLC*, Nos. 17-12560 (JKS), 19-51069 (JKS), 2025 LX 465326, at *43 (Bankr. D. Del. Oct. 20, 2025).

If there is no Ponzi scheme presumption, the trustee may attempt to establish fraudulent intent through alternative means. This can be done by alleging the traditional "badges of fraud," which include: (1) lack or inadequacy of consideration; (2) close relationships between the parties; (3) retention of possession, benefit or use of the property; (4) the financial condition of the debtor before and after the transaction; (5) a cumulative pattern of transactions following financial difficulties or threat of suits; and (6) the general chronology of the events. *See, e.g., Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, Nos. 08-01789 (CGM), 12-01576 (CGM), 2024 Bankr. LEXIS 1299, at *29 (Bankr. S.D.N.Y. June 4, 2024); *Terry v. Frost Bank (In re Chris Pettit & Assocs., P.C.)*, Nos. 22-50591-CAG, 22-50592-CAG, 24-05034-CAG, 2024 LX 73637, at *4 (Bankr. W.D. Tex. Dec. 16, 2024). The trustee, however, must plead these badges with sufficient particularity to satisfy the heightened pleading standard of Federal Rule of Civil Procedure 9(b). *Id.*

### Constructive Fraud

Under 11 U.S.C. § 548(a)(1)(B), a trustee may attempt to avoid a pre-petition transfer as constructively fraudulent if the debtor received "less than a reasonably equivalent value in exchange" and was insolvent at the time of the transfer

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or became insolvent as a result of the transfer. Courts may differentiate between the return of an investor's principal investment and the payment of "fictitious profits" that do not "represent a return on legitimate investment activity[.]" *Moyer v. Rogers (In re Wedgewood Props., LLC)*, 661 B.R. 578, 603 (Bankr. W.D. Mich. 2024). Innocent, good faith investors are generally deemed to hold colorable restitution claims for the return of their original investments. Accordingly, pre-petition payments up to the amount of the initial investment are viewed as being made for "reasonably equivalent value." *Id.* at 614. Constructive fraud recovery is therefore limited to the amounts received by an investor in excess of their initial investment (fictitious profits).

### *The in pari delicto Defense to Common Law Claims*

In addition to the above statutory claims, some trustees have attempted to assert common law claims against victims of Ponzi schemes. In response, defendants have asserted the affirmative defense of "in pari delicto" to such common law claims, which "precludes a plaintiff who participated in the same wrongdoing as the defendant from recovering damages from that wrongdoing." *Grayson Consulting, Inc. v. Wachovia Sec., Inc. (In re Derivium Capital LLC)*, 716 F.3d 355, 367 (4th Cir. 2013) (citing *In re Bogdan*, 414 F.3d at 514 (describing in pari delicto as "an affirmative defense that bars a wrongdoer from recovering against his alleged coconspirators")). Obviously the trustee is not the "wrongdoer" but the trustee steps in the shoes of the debtor to assert common law claims. *Sender v. Buchanan (In re Hedged-Investments Assocs.)*, 84 F.3d 1281, 1285 (10th Cir. 1996) (11 U.S.C. § 541 "establishes the estate's rights as no stronger than they were when actually held by the debtor . . . Congress intended the trustee to stand in the shoes of the debtor and 'take no greater rights than the debtor himself had.'") (citations omitted). That is, the trustee cannot recover damages if the debtor bears equal or greater fault in the alleged tortious conduct as the alleged tortfeasor. In short, because the debtor was the vehicle to commit the Ponzi scheme, the debtor's misconduct is imputed to the trustee.

### *Conclusion*

Ponzi scheme bankruptcies have required courts to develop specific doctrines to protect victims while also prohibiting trustees from overreaching against good faith investors. Section 548 permits a trustee to avoid transfers made with actual fraudulent intent—often established through the Ponzi scheme presumption—and to recover fictitious profits exceeding an investor's principal contribution as constructively fraudulent transfers. Yet the trustee's recovery powers are not unlimited: good-faith investors may retain payments representing a return of principal, and the in pari delicto doctrine may bar common law claims derived from the debtor's own misconduct. The viability and extent of recovery therefore depend on the nature of the claim, the value exchanged and the defenses available to the recipient.

*J. Gabriel Dennery is an attorney working of counsel at Dennery, PLLC, where he represents primarily individuals and some small businesses in bankruptcy-related matters. Gabriel earned his J.D., cum laude, from the University of Kentucky, where he received a CALI Award in Law and Economics and competed in the Duberstein Bankruptcy Moot Court Competition. He is admitted to practice in the state and federal courts of Kentucky as well as the Federal District Court for the Southern District of Indiana.*

Dennery

*Keith Larson is the managing partner at Morgan Pottinger McGarvey. He represents secured and unsecured creditors, equity interest holders, bankruptcy trustees and acquirers of troubled businesses in a wide variety of bankruptcy and workout matters. Keith has briefed and argued cases in the U.S. Courts of Appeals for the Sixth, Seventh and Eighth Circuit as well as in state appellate courts, including issues of first impression.* ■

Larson

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# DIVERSITY AND INCLUSION CORNER

September is anchored by Hispanic Heritage Month, one of the most significant cultural observances of the fall. It is also a month that asks the legal profession to look honestly at language access, literacy barriers and who gets left behind when the law assumes everyone can navigate it equally.

**SEPTEMBER 15 - OCTOBER 15**

## Hispanic Heritage Month

Hispanic Heritage Month is observed from September 15 to October 15, beginning mid-month because the independence anniversaries of many Latin American countries fall on or around September 15. The observance celebrates the culture, history and contributions of Hispanic and Latino Americans to the United States. For the legal profession, it is an opportunity to examine representation at every level of the bar, from law school enrollment to firm leadership to the bench. It is also a prompt to ask whether your practice is genuinely accessible to Louisville's growing Hispanic and Latino community, not just in theory, but in the languages you speak, the materials you produce and the relationships you build.

## PUTTING IT INTO PRACTICE

*Four concrete actions to bring September's awareness focuses into your day-to-day practice.*

1. **Know your community's demographics**
Do you know what percentage of Louisville's population is Hispanic or Latino? Start there before claiming your practice serves the community. Jefferson County's Hispanic population has grown significantly over the past decade. The clients are there. The question is whether your firm is ready to meet them.

2. **Audit your Spanish-language access**
Are your intake forms, client letters and website accessible to Spanish-speaking clients? If nothing is available in Spanish, that is a barrier worth addressing this month. Interpreter access and translated materials are not extras. They are fundamentals of equitable representation.

3. **Recognize Hispanic Heritage Month with substance**
A social post is a starting point, not a finish line. Consider a member spotlight, a practice area highlight or a team conversation about Hispanic and Latino representation in the Louisville legal community. Acknowledgment without action is just visibility.

4. **Connect D&I and mental health this month**
National Suicide Prevention Month and Hispanic Heritage Month share September. Mental health disparities along racial and ethnic lines are a D&I issue as much as a wellness one. Read what the H&W Committee has to say this month and consider how your firm can address both together.

*The D&I Committee works year-round to bring meaningful programming and honest conversation to the LBA and the Louisville legal community. New members from any practice area and experience level are welcome. The only requirement is a genuine commitment to the work. If this month's focuses sparked something for you, we'd love to hear from you.*
*Contact Lisa M. Murray at lmurray@loubar.org to learn more.*

**LBA Diversity & Inclusion Committee co-chaired by**
Michelle L. Duncan, Dinsmore & Shohl, LLP and John E. Selent, Dinsmore & Shohl, LLP

*This monthly feature is prepared by the LBA Diversity & Inclusion Committee. Questions, submissions or ideas for future columns are welcome. Contact Lisa at lmurray@loubar.org.*