No. 19-0452

IN THE SUPREME COURT OF TEXAS

RALPH S. JANVEY, in his Capacity as Court-Appointed Receiver for the Stanford International Bank Limited, et al.,

Plaintiff-Appellant,

v.

GMAG, L.L.C.; MAGNESS SECURITIES, L.L.C.; GARY D. MAGNESS; MANGO FIVE FAMILY INCORPORATED, in its Capacity as Trustee for the Gary D. Magness Irrevocable Trust,

Defendants-Appellees.

On Certified Question from the
United States Court of Appeals for the Fifth Circuit, Case No. 17-11526

AMICUS CURIAE BRIEF FOR NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES IN SUPPORT OF PLAINTIFF-APPELLANT

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The National Association of Bankruptcy Trustees ("NABT") respectfully submits this *amicus curiae* brief in support of Plaintiff-Appellant Ralph S. Janvey, Court-Appointed Receiver for the Stanford International Bank Limited, et al. ("Appellant"), pursuant to Texas Rule of Appellate Procedure 11.

IDENTITY AND INTEREST OF AMICUS CURIAE

NABT is a nonprofit professional association formed in 1982 to address the needs of chapter 7 bankruptcy trustees throughout the country, and to promote the effectiveness of the bankruptcy system as a whole. There are approximately 1,200 bankruptcy trustees receiving new cases, and approximately 1,000 of them are NABT members. NABT provides its expertise on bankruptcy issues to Congress, the Office of the United States Trustee, and the Administrative Office of the United States Courts, as well as other organizations involved in bankruptcy or with the legislative process. To that end, NABT leadership has testified before Congress and in various administrative forums, and regularly speaks at meetings of professional organizations around the country.

A fundamental duty of bankruptcy trustees is to maximize the assets available for distribution to creditors. *See Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985). One of the most important tools given by Congress to trustees (or other estate representatives) to achieve that objective is the power to avoid and recover certain pre-bankruptcy transfers by a debtor, including fraudulent

transfers that place assets outside the reach of the debtor's creditors. *See id*. The trustee's rights and remedies in fraudulent transfer litigation are subjects of great importance to NABT members, subjects on which NABT has on prior occasions been permitted to contribute its insight as *amicus curiae* in the U.S. Supreme Court and federal courts of appeal.[1]

A primary purpose of a trustee's avoiding powers is to "facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor." *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (quoting H.R. Rep. No. 95-595 at 177-78 (1977)). In cases such as this one, the recovery of fraudulent transfers from participants in a Ponzi scheme is likely the only means of ensuring an equitable distribution among defrauded creditors. Avoidance and recovery of such transfers often turn on questions of state law, since a bankruptcy trustee has the ability under 11 U.S.C. § 544(b) to avoid transfers that an unsecured creditor could have avoided under applicable non-bankruptcy law. Accordingly, resolution of the certified question in this appeal may significantly affect the ability of NABT's members to achieve a central objective of the Bankruptcy Code, not just in cases decided under Texas law, but also under the law of other jurisdictions that may look to this Court's

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[1] *See, e.g., Merit Mgmt. Group, LP, v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018); *In re Bernard L. Madoff Inv. Sec. LLC*, 917 F.3d 85 (2d Cir. 2019); *Ritchie Capital Mgmt., LLC v. Stoebner*, 779 F.3d 857 (8th Cir. 2015); *Peterson v. McGladrey & Pullen, LLP*, 676 F.3d 594 (7th Cir. 2012).

decision as persuasive authority in interpreting their own versions of the Uniform Fraudulent Transfer Act.

Pursuant to Texas Rule of Appellate 11(c), NABT confirms that no fee has been or will be paid for preparing this brief. NABT's counsel prepared this brief on a pro bono basis. NABT confirms that copies of this brief have been served on all parties, as reflected in the certificate of service.

SUMMARY OF ARGUMENT

May a recipient of a fraudulent transfer who has reason to suspect fraud intentionally avoid learning the truth and thereafter invoke a "good faith" defense? From the perspective of innocent creditors represented by NABT's members, the certified question virtually answers itself. Burying one's head in the sand—in the face of facts calling for further investigation—does not manifest the "good faith" required for a recipient to keep a fraudulent transfer that would otherwise be void. And for good reason—it would be terrible public policy; fortunately, it is not supported by this Court's longstanding precedent or the statutory text of the Texas Uniform Fraudulent Transfer Act ("TUFTA").

It has been Texas law for over 150 years that a transfer made with actual intent to hinder, delay, or defraud creditors—*i.e.*, an actual fraudulent transfer—is void against a transferee who had reasonable grounds for suspicion, even if the transferee gave adequate consideration in exchange. TUFTA had no effect on this precedent.

It would be a radical departure to now hold that a transferee who is *actually aware* of suspicious circumstances, but does nothing to allay those suspicions, may avail itself to a "good faith" defense and keep the fraudulent transfer based on a hindsight, hypothetical argument that any investigation would have been futile. This is because a transferee who is aware of dubious facts, but does nothing to investigate, is necessarily still aware of those facts—and therefore lacking good faith—when taking the transfer.

To escape this seemingly obvious conclusion, Appellees resort to semantics and a *non-sequitur* that conflates whether the transferee will be imputed with knowledge of *additional* facts with the concept of "good faith." Courts use "inquiry notice" and similar terminology in two different ways: (1) *broadly*, to refer to circumstances where there is reasonable grounds for suspicion; and (2) *narrowly*, referring to imputed knowledge of facts that would have been uncovered through a reasonably diligent investigation (presupposing that there is a duty to investigate based on reasonable grounds for suspicion). In cases addressing "inquiry notice" in the narrow sense, imputed knowledge of additional facts only extends to what a reasonably diligent investigation would have uncovered. Appellees seize upon language in cases discussing "inquiry notice" in this narrow sense to argue that showing an investigation would be futile negates "inquiry notice" and thus establishes "good faith" for TUFTA purposes.

Appellees' position is logically flawed and legally unsupported. First, "inquiry notice," even in the narrow sense involving what a hypothetical investigation might reveal, depends on knowledge of suspicious circumstances triggering a duty to investigate. Thus, where further investigation would be futile and thus additional facts will not be imputed, the transferee who fails to investigate remains aware of the suspicious circumstances that triggered the duty to investigate in the first place. And a transferee with reason to believe the transfer is improper may not keep it under settled Texas law. Second, although "inquiry notice" in either sense negates it, "good faith" is a broader concept that requires honesty in fact and so does not permit transferees to turn a blind eye in the face of a duty to act. Third, the Legislature certainly could have based the affirmative defense on discoverability—as it did for limitations purposes—but instead used "good faith." Finally, permitting transferees on notice of suspicious circumstances to justify receipt of fraudulent transfers through after-the-fact futility challenges would perversely incentivize transferees to bury their heads in the sand, thereby undermining the policies that TUFTA is designed to serve.

ARGUMENT

I. "Good Faith" Requires that a Transferee Had No Reasonable Basis to Suspect the Debtor Is Acting Improperly Under the Circumstances.

It has long been the law in Texas and elsewhere that a recipient of an actual fraudulent transfer may not keep it if the transferee had reasonable grounds for suspicion of the debtor's intent or insolvency, or if the transferee otherwise failed to act honestly in fact. This Court's earlier decisions remain good law and inform the analysis of the concepts now embodied in the TUFTA "good faith" defense. TUFTA's "good faith" defense requires that a transferee act honestly in fact and without reason to suspect that the transfer was improper.

A. This Court Has Long Held that a Transferee Aware of "Red Flags" May Not Retain an Actual Fraudulent Transfer.

More than 100 years ago, this Court addressed when a transferee who has given fair value may not keep actual fraudulent transfers. This line of authority is still good law, *see infra* Part I.B, and it involves concepts that were firmly established even then. As this Court observed in *Traylor v. Townsend*, an actual fraudulent transfer is void "if the intent be known to the purchaser, or *could have been known by the use of ordinary diligence*, although the sale was made for a good and valuable consideration. A general principle so well settled as this hardly needs authority to support it." *Traylor v. Townsend*, 61 Tex. 144, 146 (1884) (emphasis added); *see also Mills v. Howeth*, 19 Tex. 257, 259 (1857) ("Nor is it necessary to prove an actual

participation in the fraud, on the part of the vendee. If he knew of the fraudulent intent of his vendors, or had knowledge of facts sufficient to excite the suspicions of a prudent man and to put him upon inquiry, it is sufficient.").

Two decisions are instructive on what "inquiry notice" means in the context of determining voidability of an actual fraudulent transfer against a transferee who gave value. The first, *Humphries v. Case* involved an assignment made with the requisite intent to hinder, delay, or defraud creditors. 22 Tex. 50 (1858). The Court's analysis focused on whether the transferee received sufficient "notice" to void the assignment, stating the law as follows:

> It is not necessary that [transferee] should have been influenced in what he did, by a like fraudulent intent, in order to avoid the assignment as to him also; or that he should have intended to assist [debtor] to defraud his creditors; or that he should have had actual knowledge that such, in fact, was the intention of [debtor]. It is sufficient to affect him with notice, if by ordinary diligence he might have known. If he had *a knowledge of such facts, as were calculated to create a suspicion that such was the purpose of [debtor], and to put him upon inquiry; if, in a word, he had reason to know or believe that such was the intention of [debtor]*, it is sufficient to avoid the assignment as to him, as effectually as if he had actually known it.

Humphries, 22 Tex. at 50 (emphasis added). Based on the facts known to the transferee, the Court observed: "Can it be doubted, that the facts were sufficient to suggest to a man of ordinary discernment, what must have been the motive" of the debtor? *Id.*

The Court further noted that to become a "*bona fide* purchaser," *i.e.*, act in good faith, the transferee "must not have had notice of the fraud being perpetrated" because "[n]otice, in such cases, makes a man a *mala fide* purchaser, although he paid value." *Id.* at 52. Thus, to be protected, the transferee "must not only have paid value, but he must not have known, *or have had reason to know, or believe*, that he was enabling his vendor to make a disposition of property, for his own benefit, which of right belonged to his creditors." *Id.* (emphasis added). Ultimately, the Court found that the facts known to the transferee were sufficient "to put him on inquiry, and to affect him with notice" as a matter of law. *Id.* at 51.

Notably, *Humphries* did not involve any additional analysis of what a hypothetical, reasonably diligent investigation would have revealed. Although the Court used terms like "on inquiry" or "upon inquiry," it did so in a broad sense, referring to whether the transferee was aware of facts that would "create a suspicion," would give "reason to know or believe" of the debtor's intention," would "suggest to a man of ordinary discernment" the debtor's motive, or would provide "the means of knowing, by the use of ordinary diligence." *Id.* at 50-52.

The second instructive decision, *Blum v. Simpson,* involved a sale made to defraud creditors, and "the only question in the case [was], did [the transferee] know of this intent, or have such notice of such facts as would excite the suspicions of a man of ordinary prudence, and put him upon inquiry as to the reason and motives."

17 S.W. 402, 402 (Tex. 1886). After discussing the surrounding facts and circumstances known to the transferee, the Court observed:

> Taking all these circumstances in connection, it does seem that there was enough *to arouse a suspicion in the mind of any prudent man* that there was an intention on the part of [debtor] to dispose of his property in such a way that, if he had any creditors, of which there was great probability, they would be deprived of all power to enforce their claims against him.

Id. at 403 (emphasis added). The Court concluded "the evidence presents an array of circumstances tending to put the appellee upon inquiry as to the fraudulent intent of [debtor] in making the sale to him." *Id.* Again, the Court did not focus on what a hypothetical, reasonably diligent investigation would have revealed in stating that the transferee was "upon inquiry," although it noted that the transferee had "made no inquiry." *Id.*

Humphries and *Blum* establish that an actual fraudulent transfer is voidable against a transferee who reasonably could believe or suspect that the transfer is wrongful based on known facts and reasonably ascertainable information. Although both decisions addressed a transferee placed "on inquiry" or "upon inquiry," they did so broadly-speaking, *i.e.* the transferee reasonably should have had concerns based on the circumstances. Neither *Humphries* nor *Blum* considered what some hypothetical investigation might have revealed. The transfers in those cases were void because the transferees were aware of facts that would "create a suspicion," would give "reason to know or believe" of the debtor's intention," would "suggest

to a man of ordinary discernment" the debtor's motive, or would provide "the means of knowing, by the use of ordinary diligence." *Humphries*, 22 Tex. at 50-52.

B. This Court's Fraudulent Transfer Precedent Is Still Good Law.

Humphries, *Blum,* and similar decisions are still good law today under the TUFTA. Although the statutory structure and legal buzzwords have evolved, the substance of when a transfer made with the actual intent to delay, defraud, or delay is avoidable against a transferee who gave fair consideration has remained the same. It has always been and remains the law that actual fraudulent transfers are not voidable against a transferee who: (1) has given up something of value fairly equivalent to that received, *i.e.*, "reasonably equivalent value," and (2) received the transfer honestly in fact in a *bona fide* transaction and without notice of the debtor's insolvency or fraudulent intent, *i.e.*, in "good faith."

The "good faith" defense under TUFTA is merely the modern linguistic twist on concepts stretching back through Article 24.02 of the Business and Commerce Code, to Article 3396 of the Business and Commerce Code, to an 1840 Act of the Republic of Texas, to the statute of 13 Elizabeth. *See Hawes v. Cent. Texas Prod. Credit Ass'n*, 503 S.W.2d 234, 236 (Tex. 1973) ("Article 24.02 is essentially similar to the earlier statute, Article 3996; and both statutes closely resemble the English fraudulent conveyance statute of 13 Elizabeth and similar statutes in other states."); *Edrington v. Rogers*, 15 Tex. 188, 194 (1855) (explaining that "a conveyance of

property, with a knowledge on the part of the vendee that the conveyance was made to hinder, delay or defraud creditors, is void under the statute, as to such creditors, though a valuable consideration be paid by the purchaser" and citing 13 Elizabeth); *see also* Richard F. Dole, Jr. & Vernon Teofan, *The Nonuniform Texas "Uniform" Fraudulent Transfer Act*, 42 SW. L.J. 1029, 1030 (1989) ("In 1987 the legislature replaced the Texas Fraudulent Transfer Act, which was derived from an 1840 Act of the Republic of Texas, with a modified version of the UFTA.").

That the underlying concepts are the same is reflected in the official comments to the UFTA.[2] Section 24.009(a) tracks UFTA § 8(a) almost verbatim,[3] which was "an adaption of the exception stated in § 9 of the Uniform Fraudulent Conveyance Act." UFTA § 8, cmt. 1. Section 9 of the Uniform Fraudulent Conveyance Act ("UFCA")[4] provides that an actual fraudulent transfer is not void against "a

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[2] In construing TUFTA, this Court considers the official comments to the UFTA. *See Janvey v. Golf Channel, Inc.*, 487 S.W.3d 560, 575 n.79 (Tex. 2016) (citing UFTA § 3, cmt. 2); *Nathan v. Whittington*, 408 S.W.3d 870, 874 (Tex. 2013) (noting that "we have also considered the comments of the National Conference of Commissioners on Uniform State Laws, which promulgated the model UFTA" and citing UFTA § 9, cmt. 1); *First Nat'l Bank of Seminole v. Hooper*, 104 S.W.3d 83, 86 (Tex. 2003) (citing UFTA § 3, cmt. 3).

[3] The Legislature made several changes to the model UFTA in enacting the TUFTA. That the Legislature made several modifications while adopting UFTA § 8(a) as proposed in the uniform law reflects a legislative intent that Section 24.009(a) should adhere closely to UFTA § 8(a).

[4] Although the Legislature never adopted the UFCA, it still provides context in ascertaining the meaning of "good faith" because UFTA § 8(a)—on which Section 24.009(a) is based—was drawn from that statute. Substantively, the UFCA defense to actual fraudulent transfers was essentially the same as the various versions of Texas fraudulent transfer statutes predating TUFTA.

purchaser for fair consideration without knowledge of the fraud at the time of the purchase." UFCA § 9. "Fair consideration," by definition, required "good faith" on the part of the transferee. *See* UFCA § 3 ("Fair consideration is given for property…[w]hen in exchange for such property, as a fair equivalent therefore, and in *good faith*, property is conveyed or an antecedent debt is satisfied.") (emphasis added). Indeed, "the real question" in assessing fair consideration was "the *good faith* of the grantee, and whether the consideration given by him is a reasonable equivalent for the property received." UFCA § 3, n.3 (emphasis added).

To qualify for the UFCA defense, therefore, the transferee needed to show both "good faith" (as part of the "fair consideration" prong) and lack of knowledge of the fraudulent nature of the transfer. This was functionally the same as the language in early Texas cases addressing *bona fide* purchasers without notice of the fraudulent nature of the transfer. Although the UFTA frames that inquiry solely in terms of "good faith," the analysis is the same.[5] The UFTA drafters understood "good faith" to encompass the notice/knowledge concepts used in earlier statutes. *See* UFTA § 8, cmt. 2 ("Knowledge of the facts rendering the transfer voidable would be inconsistent with the good faith that is required of a protected transferee.").

[5] The revised structure of the affirmative defense in UFTA § 8 is a result of the shift to "reasonably equivalent value" instead of "fair consideration," as explained in the prefatory note to the UFTA.

Accordingly, this Court's earlier decisions like *Humphries* and *Blum* remain good law. The "notice" addressed in those cases that rendered transfers voidable against transferees that provided value is now subsumed in the "good faith" analysis under the Section § 24.009(a) defense. "Good faith" as used in TUFTA combines the historical requirements of honesty in fact (or a *bona fide* transaction) and lack of notice into a single all-encompassing test, requiring both.

C. This Court's Fraudulent Transfer Precedent Is Consistent with Its Interpretation of "Good Faith" in Other Statutory Contexts.

Incorporating the objective notice standard as articulated in *Humphries*, *Blum*, and related cases into the test for "good faith" is also consistent with TUFTA's purpose, which is "to prevent debtors from prejudicing creditors by improperly moving assets beyond their reach." *Janvey v. Golf Channel, Inc.*, 487 S.W.3d 560, 566 (Tex. 2016) (citing *KCM Fin. LLC v. Bradshaw*, 457 S.W.3d 70, 89 (Tex. 2015) ("[TUFTA] is designed to protect creditors from being defrauded or left without recourse due to the actions of unscrupulous debtors."). Limiting protection to transferees who had no reason to reasonably suspect that the transfer was wrongful prevents the Section § 24.009 exception to voidability from swallowing the rule. This is why almost all Courts measure "good faith" for fraudulent transfer purposes through an "objective" lens today, and presumably why this Court employed such objective analysis in *Blum*, *Humphries*, and related cases.

This Court has also previously utilized an objective lens in ascertaining "good faith" in other statutory contexts when necessary to achieve a fair balance of competing interests. In defining "good faith" under the Whistle Blower Act,[6] the court incorporated "both subjective and objective components," holding that "'[g]ood faith' means that (1) the employee believed that the conduct reported was a violation of law and (2) the employee's belief was reasonable in light of the employee's training and experience." *Wichita Cnty., Tex. v. Hart*, 917 S.W.2d 779, 784 (Tex. 1996); *accord El Paso Healthcare Sys., Ltd. v. Murphy*, 518 S.W.3d 412, 419 (Tex. 2017). This formulation "achieves a fair balance between competing interests" as the first part protects employees acting honestly in fact while the second part protects employers by extending whistleblower protection "only if a reasonably prudent employee in similar circumstances would have believed that the facts as reported were a violation of law." *Hart*, 917 S.W.2d at 784-85.

Applying that reasoning here and considering firmly rooted precedent in the fraudulent transfer context, "good faith" for purposes of TUFTA means that the transferee: (1) acted honestly in fact in taking the transfer (*e.g.*, without collusion)

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[6] *See* TEX. GOV'T CODE § 554.002(a) ("A state or local governmental entity may not suspend or terminate the employment of, or take other adverse personnel action against, a public employee who *in good faith* reports a violation of law by the employing governmental entity or another public employee to an appropriate law enforcement authority." (emphasis added)).

and subjectively believed that the transfer was proper; and (2) was not on notice within the meaning of *Humphries* and *Blum* of the debtor's insolvency or wrongful intent (*i.e.*, transferee had no reasonable basis to suspect the transfer was improper). The latter, "objective" prong of what the transferee reasonably might suspect is assessed in light of the transferee's training, experience and sophistication. And what the transferee had reason to believe or suspect is measured by both: (1) "red flags" and other facts actually known to the transferee; and (2) any *additional* facts that the transferee reasonably should have uncovered through a reasonably diligent investigation (to the extent that a duty to investigate is triggered).

II. A Transferee with Reasonable Grounds for Suspicion Who Fails to Investigate Does Not Act in "Good Faith" Under TUFTA.

Given what "good faith" requires, it follows that a transferee who is aware of suspicious circumstances triggering a duty to investigate yet who fails to do so cannot qualify for the Section 24.009 defense. A transferee on "inquiry notice" in any sense has, by definition, reason for suspicion. Logic dictates that such a transferee who has failed to investigate continues to have reason for suspicion, which defeats "good faith." Moreover, turning a blind eye to suspicious circumstances amounts to willful ignorance, which is inconsistent with the honesty in fact that "good faith" requires. And allowing ostrich-like transferees to avail themselves to the Section 24.009 defense is inconsistent with TUTFA's statutory scheme as a whole. Although there might be limits on *additional* facts that might be imputed to

a transferee in some circumstances, any difficulties in conducting a hypothetical investigation cannot negate "red flags" already known to a transferee.

A. Logic Dictates that a Transferee on Notice Who Fails to Investigate Remains on Notice and Hence Cannot Act in "Good Faith."

When "good faith" is viewed in the appropriate light and with reference to the objective notice concepts articulated in *Humphries* and *Blum*, it becomes obvious that there should be no "futility exception" for transferee's on notice as a matter of basic logic. If a transferee is aware of "red flags" indicating insolvency or fraud and yet does nothing to investigate or allay suspicions, then the transferee remains aware of those "red flags." One on notice who does nothing necessarily remains on notice; the transferee's knowledge is unchanged by a nullity, just as X – 0 = X. And awareness of facts giving grounds for reasonable suspicion defeats the transferee's good faith under *Humphries* and *Blum*.[7] It is that simple.

B. Appellees' Argument Relies on Semantic Confusion.

Why then did the Fifth Circuit certify the question? The short answer is that the case law, especially in the related bankruptcy context, is somewhat muddled due

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[7] What a purely hypothetical reasonably diligent investigation would have revealed to a transferee who failed to investigate cannot save the transferee, as the results of such a hypothetical investigation are not available to the transferee at the time it took the transfer. A transferee aware of "red flags" who fails to investigate remains aware of those "red flags" at the time the transferee accepts the transferee, meaning that the transferee lacked a reasonable basis to believe that the transfer was proper at the relevant time period. As Appellant notes, "good faith" must be measured at the time of the transfer in question.

to imprecise use of legal jargon and two different senses in which courts often use the phrase "inquiry notice" (or refer to transferees being placed "on inquiry" or "upon inquiry"). Courts use such terminology in both a narrow sense referring to imputed knowledge based on what an investigation might reveal and in a broad sense as shorthand for what a transferee reasonably could have known or believed.

In the narrow sense, "inquiry notice" refers to imputed knowledge of facts that would have been uncovered through a reasonably diligent investigation, presupposing that there was a duty to inquire. The extent of a person's "inquiry notice" thus hinges on two considerations: (1) whether the person was aware of enough suspicious facts triggering a duty to investigate; and (2) if so, what a reasonably diligent investigation would have revealed.[8] A person is only imputed

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[8] *Flack v. First Nat'l Bank of Dalhart*, 226 S.W.2d 628, 632 (Tex. 1950) ("Whatever puts a person on inquiry ordinarily amounts in law to notice, provided inquiry has become a duty and would lead to knowledge of the facts by the exercise of ordinary diligence and understanding. In other words, one who has knowledge of such facts as would cause a prudent man to make further inquiry, is chargeable with notice of the facts which, by use of ordinary intelligence, he would have ascertained. As the rule has been more precisely stated, knowledge will be imputed and may be implied from circumstances where the circumstances known to one concerning a matter in which he is interested are sufficient to require him, as an honest and prudent person, to investigate concerning the rights of others in the same matter, and diligent investigation will lead to discovery of any right conflicting with his own. In such circumstances the person sought to be charged with notice is presumed to have knowledge of all that might have been discovered by investigation; that is to say, he is presumed to know whatever, by the diligent use of what information he has, and of the means in his power, he ought to know.") (internal quotations and citations omitted); *Wethered's Adm'r v. Boon*, 17 Tex. 143, 149-50 (1856) ("[T]here may be constructive notice, as when the party, by any circumstance whatever, is put upon inquiry, which amounts in judgment of law to notice, provided the inquiry becomes a duty. The general doctrine is, that whatever puts a party upon an inquiry amounts, in judgment of law, to notice, provided the inquiry becomes a duty, as

with knowledge through "inquiry notice" if the circumstances suffice to arouse suspicion and trigger a duty to investigate.[9] And even where a duty to investigate is triggered, a person is only on "inquiry notice"—in the narrow sense—of facts that would have been uncovered through a reasonably diligent investigation. In other words, under the second prong of "inquiry notice" analysis in the narrow sense, a person cannot be on "inquiry notice" of X if X was undiscoverable through a reasonably diligent investigation.

At the same time, however, courts use "inquiry notice" and similar terminology (such as "on notice" or "upon notice") in a broad sense to refer to circumstances where a person reasonably should have known something based on suspicious circumstances known to that person. In the broad sense, a transferee is said to be on "inquiry notice" or "upon inquiry" where that transferee is aware of "red flags" of suspicious conduct suggesting an improper purpose. *See, e.g., In re Sherman*, 67 F.3d 1348, 1355-56 (8th Cir. 1995) (without any analysis of the transferee's investigation, treating "inquiry notice" interchangeably with what the

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in the case of purchasers and creditors, and would lead to the knowledge of the requisite fact, by the exercise of ordinary diligence and understanding." (internal quotations and citations omitted)).

[9] *See Dodd v. Gaines*, 18 S.W. 618, 620 (Tex. 1891) ("There must be some facts in the knowledge of the vendee to put him upon inquiry. He would not be charged with constructive notice of the fraud if he acted innocently, in ignorance of any fact that would cause a suspicion of the fraudulent intent on the part of the vendor. . . . If the vendee knows nothing that would cause a reasonably prudent man to inquire, he would not be required to inquire, nor would he be charged with notice.").

transferee reasonably should have known based on transferee's awareness of suspicious facts and finding that transferee lacked "good faith" for purposes of the Bankruptcy Code). In other words, a transferee who could not have reasonably believed that the transaction was legitimate based on the surrounding circumstances when connecting the dots is sometimes said to be on "inquiry notice" or "on inquiry," without any reference to what some hypothetical investigation might have revealed. This Court's decisions in *Humphries* and *Blum* are illustrative of the broad use of such terminology. *See also Hahn v. Love*, 321 S.W.3d 517 (Tex. App.—Houston [1st Dist.] 2009, pet. denied) ("A transferee who takes property with knowledge of such facts as would excite the suspicions of a person of ordinary prudence and put him on inquiry of the fraudulent nature of an alleged transfer does not take the property in good faith.").

In the context of assessing "good faith" under 11 U.S.C. § 548(c), the Fifth Circuit has also referred to "inquiry notice" in the broad sense, breaking out an investigation as a second element to assess good faith. *See In re Am. Hous. Found.*, 785 F.3d 143, 164 (5th Cir. 2015). Here, the Fifth Circuit framed the certified question in that manner, as it contemplates a "transferee who had inquiry notice of the fraudulent [activity], did not conduct a diligent inquiry, but who would not have been reasonably able to discover that fraudulent activity through diligent inquiry." *Janvey v. GMAG, L.L.C.*, 925 F.3d 229, 235 (5th Cir. 2019) (per curiam). In this

phrase, "inquiry notice" must be viewed in the broad sense—*i.e.*, the transferee was aware of "red flags"—and not in the narrow sense, as otherwise the question would be internally inconsistent.[10]

Against that backdrop, Appellees' position largely amounts to semantics. It depends on a hyper-technical and narrow use of "inquiry notice" focusing solely on what a hypothetical investigation would have revealed. Because "inquiry notice" in the narrow sense is limited to what a reasonably diligent investigation would have revealed, a transferee is not on "inquiry notice" of X—in the narrow sense—where a hypothetical diligent investigation would not have uncovered X. From there, Appellees make a logical leap to argue that lack of "inquiry notice"—in the narrow sense—equates to "good faith" for purposes of TUFTA § 24.009(a). Thus, Appellees posit, a transferee's knowledge of "red flags" or suspicious circumstances is inconsequential for "good faith" so long as an investigation would have proven futile in uncovering a fraudulent scheme.

Appellees' position is inconsistent with historical precedent and any fair reading of "good faith." First, as discussed above, "good faith" requires lack of a reasonable basis to believe that the transfer was improper (due to the debtor's insolvency, intent, etc.). If a transferee is aware of "red flags" that create reasonable

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[10] Again, in the narrow sense, a person cannot have "inquiry notice" of a fact that could not have been discovered through reasonably diligent inquiry.

cause for suspicion but does nothing to allay such concerns, then the transferee logically must continue to have reasonable basis for suspicion at the time of the transfer. Actual fraudulent transfers have been voided in such circumstances for the last 150+ years under Texas law.

Second, Appellees' position is a *non-sequitur*. Although a transferee's "inquiry notice" negates "good faith" defenses, it does not follow that the converse is also true. Merely (a) *lacking* "inquiry notice" in the narrow sense does not necessarily equate to (b) *taking* "in good faith" within the meaning of the UFTA because the latter is a much broader concept. "Good faith" requires honesty in fact, which is fundamentally inconsistent with willful ignorance, as this Court has previously held in interpreting "good faith" in other statutes. *See R.R. Comm'n of Tex. v. Gulf Energy Exploration Corp.*, 482 S.W.3d 559, 569 (Tex. 2016) ("[A] good-faith effort . . . requires conduct that is honest in fact and is free of both improper motive and willful ignorance of the facts at hand."). For this reason, the majority of courts have held that failure to investigate in the face of "red flags" triggering a duty to investigate negates a transferee's "good faith" defenses to fraudulent transfers. *See, e.g., Ameriserv Fin. Bank v. Commercebank, N.A.*, No. CIV.A. 07-1159, 2009 WL 890583, at *6 (W.D. Pa. Mar. 26, 2009) ("Defendant could not . . . sit on its heels and yet retain those funds as a good faith transferee" under Pennsylvania UFTA." (internal quotation omitted)); *In re Harbour*, 845 F.2d

1254, 1258 (4th Cir. 1988) (stating that a transferee's "willful ignorance in the face of facts which cried out for investigation may not support a finding of good faith" under the Bankruptcy Code). By its plain text, the Section § 24.009(a) affirmative defense applies to those "who *took* in good faith," implying positive action. TEX. BUS. & COM. CODE § 24.009(a) (emphasis added).

Third, the plain text of Section § 24.009(a) refers to "good faith," not to discoverability. If the Legislature or the UFTA drafters intended for the defense to turn on the transferee's actual or reasonable ability to discover the fraudulent nature of the transfer, then they could have so provided. In fact, they did so in the context of calculating the limitations period for actual fraudulent transfers. *See* TEX. BUS. & COM. CODE § 24.010(a)(1) (providing that actual fraudulent transfer may be avoided "within one year after the transfer or obligation was or could reasonably have been discovered by the claimant"). The express inclusion of discoverability concepts for one purpose (limitations) but not others (the Section 24.009(a) defense) suggests that the latter should not be restricted to discoverability. Yet that is exactly what Appellees' position amounts to by arguing that the "good faith" defenses hinges on what "could reasonably have been discovered."

Finally, NABT strongly agrees with the policy arguments raised by Appellant. NABT is particularly concerned that recognizing a "futility exception" as advocated by Appellees would create perverse incentives by encouraging

transferees to bury their heads in the sand. Why bother to investigate in real-time if a transfer could be defended after-the-fact by arguing futility, especially since a contemporaneous investigation might very well confirm the transferee's worst fears? If TUFTA allowed for a post-hoc futility defense, transferees with have little to gain and everything to lose by investigating contemporaneously.

C. Decisions Addressing "Inquiry Notice" in the Narrow Sense Do Not Conflict with This Result.

The foregoing does not mean that a transferee's actual or hypothetical investigatory efforts are irrelevant to "good faith" analysis. Nor does it mean that cases addressing "inquiry notice" in the strict sense are incongruous; the muddled lines of authority are easily harmonized when focusing on substance rather than semantics.

At the outset, a duty to investigate is not triggered until there are adequate "red flags" to arouse suspicion in the transferee. If there are not adequate "red flags" to trigger a duty to investigate under "inquiry notice" analysis in the narrow sense, then presumably the transferee would not have reason to believe that the transfer was wrongful and would not be "on inquiry" in the broad sense either. Thus, a transferee will not be on "inquiry notice" in either sense where there are insufficient indicia of problems to present a reasonable basis for suspicion.

Once there is a reasonable basis for suspicion,[11] there are three potential scenarios: (1) the transferee conducts no investigation at all; (2) the transferee conducts a shoddy investigation; or (3) the transferee conducts a reasonably diligent investigation. In turn:

1. A transferee who conducts no investigation—despite a duty to investigate—is charged with notice of all "red flags" or suspicious facts actually known to the transferee as well as any *additional* facts that a reasonably diligent investigation based on known facts would have revealed.
2. A transferee who conducts a shoddy investigation will be charged with knowledge of any "red flags" that remained after that investigation, any new "red flags" uncovered as part of the investigation, and any facts that would have been revealed through a reasonably diligent investigation.
3. A transferee who conducts a reasonably diligent investigation will be charged only with knowledge of any "red flags" that

[11] Definitionally, a transferee on "inquiry notice" in the narrow sense has reason to believe that the transfer is wrongful; absent reasonable grounds for suspicion, there is no triggering duty to investigate.

remained after that investigation (and of any new facts uncovered as part of the investigation).

The transferee who fails to investigate will necessarily lack "good faith" for the reasons addressed above, *i.e.*, the transferee had a reasonable basis for suspicion with no offsetting knowledge. In the latter two scenarios (where the transferee investigated), the transferee's "good faith" will ultimately depend on the results of the investigation and the totality of the resulting circumstances and remaining knowledge. The results of the investigation—including what reasonably could have been discovered in the case of a shoddy investigation—could tip the scales either way on what the transferee reasonably could have believed at the time of the transfer, and hence, whether the transferee could have taken the transfer in "good faith."

In short, "good faith" depends on both honesty in fact and lack of an objective basis to believe that the debtor was insolvent or acting wrongfully. Whether a transferee on notice of some "red flags" who conducts an investigation will qualify depends on the facts and circumstances following the investigation (supplemented by what a reasonable investigation would have revealed if the investigation was shoddy). But a transferee who had a reasonable basis for suspicion and did nothing cannot act in "good faith" because that person took the transfer while actually aware of facts creating suspicion. A hypothetical investigation cannot retroactively negate suspicious circumstances known to the transferee at the time of the transfer.

CONCLUSION AND PRAYER

NABT respectfully requests that the Court answer the certified question in the negative as suggested by Appellant.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Texas Rule of Appellate Procedure 9.4(i)(3), I hereby certify that according to the computer program used to it, this brief contains 6524 words, excluding those portions of the brief exempted by Rule 9.4(i)(1).

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