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Consumer Protection and Unfair Competition Law

ALERT

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Eighth Circuit Holds Consumer Payments To Debt Settlement Company Not Avoidable In Bankruptcy Where "Reasonably Equivalent Value" Was Provided

By Michael Mallow and Michael A. Thurman

The Eighth Circuit Court of Appeals Bankruptcy Panel has upheld a North Dakota federal district court's ruling that payments to a debt settlement company were not avoidable as "fraudulent transfers" in a Chapter 7 bankruptcy proceeding.

In *Kendall v. Able Debt Settlement, Inc.*, No. 10-6056 (B.A.P. 8th Cir. December 9, 2010), the appellate court agreed with the lower court's determination that the agreement was "an arm's length transaction between a willing buyer and willing seller, was entered into in good faith and for fair market value."

The case was brought by a bankruptcy trustee who sought to recover $1,708.37 in service fees paid by Grant and Andrea Kendall to Able Debt Settlement, Inc. from February 2008 to February 2009. The trustee argued that the debt settlement services were prohibited by North Dakota's "debt adjusting" law and that the program's purpose of avoiding bankruptcy was impossible to accomplish.

The Bankruptcy Code allows a bankruptcy trustee to avoid a payment made by a consumer within two years of filing bankruptcy if the consumer "received less than a reasonable equivalent value" in exchange for the payment.

The Court initially considered the lower court's ruling that debt settlement is not prohibited by North Dakota's debt adjusting statute so long as the debt settlement company does not handle the consumer's money. However, the Court of Appeals decided that it was unnecessary to decide whether the lower court's analysis was correct since the Bankruptcy Code contains no "illegality exception" to the "reasonably equivalent value" requirement. The Court held that, regardless of whether debt settlement was legal or illegal in North Dakota, the trustee was still obligated to demonstrate that the consumers did not receive value from the program.

The Court considered the terms of the debt settlement agreement and the disclosures that were provided to the consumers to evaluate whether they received "reasonably equivalent value" for their debt settlement payments. It concluded that the Kendalls "knew the cost, the requirements, and the risk of the program, and decided it was worth it."

Rejecting the trustee's argument that the program's goal, avoiding bankruptcy, was impossible for the Kendalls to achieve, the Court stated, "It is not necessarily incredible for debtors to believe they can tighten their belts to make desired payments; indeed, debtors in Chapter 13 bankruptcy cases or those seeking to reaffirm debts frequently say, and do, just that."

The Court also rejected the trustee's argument that success in the program was impossible because creditors inevitably would not agree to accept the reduced payments that were being offered on behalf of the Kendalls:

"[T]here was no actual evidence that Able could not have ultimately negotiated workable amounts with the creditors as a whole – indeed, Able was still in the process of negotiating with many of the creditors when the Kendalls withdrew from the program. And, as stated, the program had no guarantees. At the time the Kendalls entered the program, there was no way of knowing for sure how the negotiations would go … So long as there is some chance that a contemplated investment will generate a positive return at the time of the disputed transfer, value has been conferred."

In re: Kendall v. Able Debt Settlement, Inc., No. 10-6056 (B.A.P. 8th Cir. December 9, 2010).

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