

56 F.3d 750  
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United States Court of Appeals,  
Seventh Circuit.

Steven S. SCHOLLES, as Receiver for Michael S.  
Douglas, D & S Trading Group,  
Ltd., Analytic Trading Systems, Inc., and Analytic  
Trading Service, Inc.,  
Plaintiff-Appellee,

v.

Charles LEHMANN and Lisa Lehmann, Joseph E.  
Phillips, African Enterprise, Inc.,  
et al., Defendants-Appellants.

Nos. 94-2039, 94-2136, 94-2718 and 94-2947.

Argued Feb. 17, 1995.  
Decided May 18, 1995.

Rehearing and Suggestion for Rehearing En Banc  
Denied July 12, 1995.

Receiver for corporations owned by Ponzi scheme principal brought fraudulent conveyance action against Ponzi scheme investor, principal's former spouse, and religious organizations that received funds from corporations. The United States District Court for the Northern District of Illinois, James H. Alesia, J., granted summary judgment for receiver, 850 F.Supp. 707 and 854 F.Supp. 1315, and transferees appealed. The Court of Appeals, Posner, Chief Judge, held that: (1) receiver had standing to assert fraudulent conveyance claims; (2) transfers to investor in excess of initial investment were fraudulent conveyances; (3) transfers to spouse in excess of spouse's valid claims against principal were fraudulent conveyances; and (4) fraudulent conveyance statute could not be interpreted to exclude gifts to religious groups and other charitable organizations.

Affirmed in part, reversed in part, and remanded.

West Headnotes

**[1] Fraudulent Conveyances** ↪73.1  
186k73.1 Most Cited Cases

If transfer is made for commensurate consideration it is not voidable. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[2] Corporations** ↪560(7)

101k560(7) Most Cited Cases

Receiver for corporations owned by Ponzi scheme principal had standing to assert fraudulent conveyance claims to recover amounts transferred by corporations; receiver was acting on behalf of corporations and not Ponzi scheme investors because corporations were legal entities separate from principal and injured by transfers.

**[3] Receivers** ↪167  
323k167 Most Cited Cases

Like bankruptcy trustee or plaintiff in derivative suit, equity receiver may sue only to redress injuries to entity in receivership, corresponding to debtor in bankruptcy and corporation of which plaintiffs are shareholders in derivative suit.

**[4] Corporations** ↪215  
101k215 Most Cited Cases

Sole shareholder could lawfully have ratified diversion of corporate assets to noncorporate purposes, but only if creditors were not harmed.

**[5] Fraudulent Conveyances** ↪173.1  
186k173.1 Most Cited Cases

**[5] Fraudulent Conveyances** ↪179(1)  
186k179(1) Most Cited Cases

Maker of fraudulent conveyance and all those in privity with maker are bound by it.

**[6] Fraudulent Conveyances** ↪76(1)  
186k76(1) Most Cited Cases

**[6] Fraudulent Conveyances** ↪77  
186k77 Most Cited Cases

Fraudulent conveyance statute required full consideration before transfer was placed beyond statute's reach. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[7] Contracts** ↪47  
95k47 Most Cited Cases

Purposes served by contract law's requirement of consideration include cautionary function of bringing home to promisor fact that promise is legally enforceable and evidentiary function of making it more

likely that enforceable promise was intended; however, consideration requirement does not identify fair exchanges.

**[8] Contracts** ⚙️53  
95k53 Most Cited Cases

Unless fraud or mistake is alleged, court ordinarily will not even permit inquiry into adequacy of consideration for promise or transfer.

**[9] Fraudulent Conveyances** ⚙️64(1)  
186k64(1) Most Cited Cases

If plaintiff asserting fraudulent conveyance proves fraudulent intent, transfer is deemed fraudulent even if it is in exchange for valuable consideration. S.H.A. 740 ILCS 160/5(a)(1).

**[10] Fraudulent Conveyances** ⚙️314  
186k314 Most Cited Cases

Ponzi scheme payments to investor representing net profits in excess of initial investment were fraudulent conveyance that investor was not entitled to retain. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[11] Fraudulent Conveyances** ⚙️104(.5)  
186k104(.5) Most Cited Cases

Payments by Ponzi scheme principal to principal's former wife were fraudulent conveyances except to extent that wife had valid claims against principal. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[12] Corporations** ⚙️1.6(5)  
101k1.6(5) Most Cited Cases

Standing of receiver for corporations created by Ponzi scheme principal to assert fraudulent conveyance claims would not be affected by corporations' status as principal's alter ego; availability of reverse veil piercing to reach corporate assets would not render corporations incapable of being injured by allegedly fraudulent conveyances. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[13] Corporations** ⚙️1.6(3)  
101k1.6(3) Most Cited Cases

Direct piercing of corporate veil occurs when creditors of corporation are trying to reach shareholder.

**[14] Corporations** ⚙️1.6(3)  
101k1.6(3) Most Cited Cases

Reverse piercing of corporate veil occurs when creditors of shareholder are trying to reach corporation.

**[15] Corporations** ⚙️1.6(3)  
101k1.6(3) Most Cited Cases

Reverse piercing of corporate veil is ordinarily possible only in one-person corporation; if there is more than one shareholder, seizing corporation's assets to pay shareholder's debts would be wrong to other shareholders.

**[16] Fraudulent Conveyances** ⚙️277(3)  
186k277(3) Most Cited Cases

Former wife of Ponzi scheme principal had burden to prove that consideration for allegedly fraudulent conveyances was adequate and commensurate, given scale of transfers and family setting. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[17] Federal Civil Procedure** ⚙️2498.8  
170Ak2498.8 Most Cited Cases  
(Formerly 170Ak2481)

Fact issues as to actual fraudulent intent by Ponzi scheme principal's former wife who received from principal's corporations amounts exceeding any plausible legal obligation of principal precluded summary judgment determination in fraudulent conveyance action that wife would not be entitled to keep any part of money she received from corporation, despite strong circumstantial evidence of fraud in fact. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[18] Fraudulent Conveyances** ⚙️314  
186k314 Most Cited Cases

Inadequate consideration is not element of fraud in fact that would make recipient of fraudulent conveyance liable to return all sums received. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[19] Fraudulent Conveyances** ⚙️315(1)  
186k315(1) Most Cited Cases

**[19] Fraudulent Conveyances** ⚙️318  
186k318 Most Cited Cases

Finding of actual fraud on part of Ponzi scheme principal's former wife who received fraudulent conveyances would not extinguish wife's claims against principal that fraudulent conveyances were used to satisfy; claims would simply be thrown into pool with claims of other creditors.

**[20] Corporations** ↪542(1)  
101k542(1) Most Cited Cases

Lack of consideration entitled receiver for Ponzi scheme principal's corporations to recover as fraudulent conveyances gifts to religious corporations.

**[21] Charities** ↪4  
75k4 Most Cited Cases

Gift to charity is not in exchange for full commensurate consideration.

**[22] Federal Courts** ↪613  
170Bk613 Most Cited Cases

Court of Appeals would not consider religious corporation's First Amendment defense to fraudulent conveyance action to recover transfers from corporations owned by Ponzi scheme principal, where constitutional challenge to state fraudulent conveyance statute was not raised in district court. U.S.C.A. Const.Amend. 1.

**[23] Federal Courts** ↪613  
170Bk613 Most Cited Cases

Federal courts should be especially reluctant to invalidate statutes on constitutional grounds by use of procedural shortcuts, such as pursuant to issues not raised in court below.

**[24] Fraudulent Conveyances** ↪73.1  
186k73.1 Most Cited Cases

Fraudulent conveyance statute could not be interpreted to exclude gifts to religious groups and other charitable organizations. Ill.Rev.Stat.1989, ch. 59, ¶ 4.

**[25] Federal Courts** ↪896.1  
170Bk896.1 Most Cited Cases

**[25] Federal Courts** ↪901.1  
170Bk901.1 Most Cited Cases

Irregularities in evidence are material only when material facts are disputable and disputed; otherwise, they are harmless error and can be ignored.

**[26] Evidence** ↪207(4)  
157k207(4) Most Cited Cases

Ponzi scheme principal's plea agreement was admissible hearsay in fraudulent conveyance action against recipients of funds from principal's

corporations. Ill.Rev.Stat.1989, ch. 59, ¶ 4; Fed.Rules Evid.Rule 803(22), 28 U.S.C.A.

**[27] Evidence** ↪43(3)  
157k43(3) Most Cited Cases

District court could take judicial notice of Ponzi scheme principal's plea agreement in fraudulent conveyance action against recipients of funds from principal's corporations. Ill.Rev.Stat.1989, ch. 59, ¶ 4; Fed.Rules Evid.Rule 201, 28 U.S.C.A.

**[28] Evidence** ↪265(11)  
157k265(11) Most Cited Cases

Witness should not be permitted by subsequent affidavit to retract admissions in plea agreement.

**[29] Judges** ↪39  
227k39 Most Cited Cases

Reversal of fraudulent conveyance judgment was not warranted by letters to judge from Ponzi scheme investors that judge described as "very sad," where letters had no bearing on legal issues and there was no indication that judge was swayed by them; unauthorized communications about case did not require recusal.

**[30] Judges** ↪39  
227k39 Most Cited Cases

Judges are not sequestered and do not have to recuse themselves because interested nonparty writes something about case that judge reads.

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Before POSNER, Chief Judge, and MANION and KANNE, Circuit Judges.

POSNER, Chief Judge.

Michael Douglas masterminded a Ponzi scheme that has given rise to the interesting and important issues of fraudulent-conveyance law which these appeals require us to consider. Here is how the scheme operated (approximately--we shall simplify the facts for the sake of clarity). Douglas created three corporations and caused them in turn to create limited partnerships in which the corporations would be the general partners and would sell limited-partner interests to the investing public. The corporations represented to prospective investors that the limited partnerships would trade commodities and yield the limited partners a return of 10 to 20 percent per month on their investment. Although some trading of commodities was done, most of the money raised from the sale of the limited-partner interests was used simply to pay the promised return. These payments gave the scheme credibility, enabling Douglas to sell additional limited-partner interests. The scheme was launched in 1987 and by the time it crashed in 1989 Douglas's corporations had raised \$30 million from the sale of limited-partner interests. Douglas was prosecuted for fraud, pleaded guilty, and is serving a 12-year federal prison sentence.

The Securities and Exchange Commission brought this civil suit against Douglas and his three corporations in 1989, charging multiple violations of federal securities laws. The Commission asked the district court to appoint a receiver for Douglas and the corporations. The court obliged, appointing Steven Scholes of the McDermott firm. To date \*753 Scholes has recovered \$12 million, consisting mainly of property of Michael Douglas that Douglas had bought with money that he had siphoned from the corporations, which in turn had obtained the money from the sale of shares in the limited partnerships. The receiver has distributed the recovered funds to the investors in the Ponzi scheme who lost money, with the result that, thus far, each has recovered 40 percent of his losses.

The appeals that we have consolidated for decision arise from the receiver's efforts to recover additional assets from Douglas's ex-wife (Lisa Lehmann) and her husband, from one of the investors in the Ponzi scheme who was lucky enough to make money (Joseph Phillips), and from five religious corporations. The law under which the receiver proceeded is the Illinois law of fraudulent conveyances as it stood in 1989.

Ill.Rev.Stat. ch. 59, ¶4 (1987). That law was repealed the following year when Illinois adopted the Uniform Fraudulent Transfer Act, 740 ILCS 160, and later we shall consider the possible bearing of the new law on this case. Federal jurisdiction is based on the ancillary jurisdiction of the federal courts, Pope v. Louisville, New Albany & Chicago Ry., 173 U.S. 573, 577, 19 S.Ct. 500, 501, 43 L.Ed. 814 (1899); Tcherepnin v. Franz, 485 F.2d 1251, 1255-56 (7th Cir.1973)--now a part of their statutory "supplemental" jurisdiction, 28 U.S.C. § 1367; David D. Siegel, "Practice Commentary," 28 U.S.C.A. § 1367, pp. 829, 830-31 (1993); Unique Concepts, Inc. v. Manuel, 930 F.2d 573, 574 (7th Cir.1991), which furnishes the jurisdictional basis for one of the three suits because it was filed after December 1, 1990, the effective date of 28 U.S.C. § 1367. The laying of venue for all three suits in the Northern District of Illinois is authorized by 28 U.S.C. § 754, which allows a receiver to sue in the district in which he was appointed to enforce claims anywhere in the country. The district court granted summary judgment for the receiver against all the defendants and entered judgments of \$299,000 against the Lehmanns, \$377,000 against Phillips, and \$509,000 against the religious corporations.

[1] The (old) fraudulent-conveyance statute provided that "every gift ... or transfer ... made with the intent to disturb, delay, hinder or defraud creditors or other persons ... shall be void as against such creditors ... and other persons." It is apparent from the wording of the statute, as well as from its purpose, that if a transfer is made for commensurate consideration--if it is "fair" in the sense of being one side of an equal exchange--it is not voidable. For creditors are not disturbed, delayed, hindered, or defrauded if all that happens is the exchange of an existing asset of the debtor for a different asset of equal value. United States v. Kitsos, 770 F.Supp. 1230, 1235 n. 14 (N.D.Ill.1991) (interpreting Illinois law), *aff'd* without opinion, 968 F.2d 1219 (7th Cir.1992); see also In re Xonics Photochemical, Inc., 841 F.2d 198, 202 (7th Cir.1988); Boston Trading Group, Inc. v. Burnazos, 835 F.2d 1504, 1513-14 (1st Cir.1987). (Compare the "indubitable equivalent" provision of bankruptcy law. 11 U.S.C. § 1129(b)(2)(A)(iii); In re James Wilson Associates, 965 F.2d 160, 172 (7th Cir.1992).) This implies, the defendants argue, that the only transfers reached by the statute are those made without consideration; and they claim that the transfers to them were supported by consideration and therefore that the receiver's suits must fail. We shall get to that, the central issue in these appeals, in a moment, but we must first consider whether receiver Scholes even had standing to bring the suits.

[2][3] The argument that he did not is that he was "really" suing on behalf not of Douglas or Douglas's corporations, the perpetrator and tools of the Ponzi scheme, respectively, but of the investors, the purchasers of limited-partners interests in the corporations; and a receiver does not have standing to sue on behalf of the creditors of the entity in receivership. Like a trustee in bankruptcy or for that matter the plaintiff in a derivative suit, an equity receiver may sue only to redress injuries to the entity in receivership, corresponding to the debtor in bankruptcy and the corporation of which the plaintiffs are shareholders in the derivative suit. Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed.2d 195 (1972); Steinberg v. Buczynski, 40 F.3d 890, 892 (7th Cir.1994); \*754Schacht v. Brown, 711 F.2d 1343, 1346 n. 3 (7th Cir.1983); Boston Trading Group, Inc. v. Burnazos, *supra*, 835 F.2d at 1514-16. How, the defendants ask rhetorically, could the allegedly fraudulent conveyances have hurt Douglas, who engineered them, or the corporations that he had created, that he totally controlled and probably (the record is unclear) owned all the common stock of, and that were merely the instruments through which he operated the Ponzi scheme?

The answer--so far as the corporations are concerned, and we need go no further--turns out to be straightforward. The corporations, Douglas's robotic tools, were nevertheless in the eyes of the law separate legal entities with rights and duties. They received money from unsuspecting, if perhaps greedy and foolish, investors. That money should have been used for the stated purpose of the corporations' sale of interests in the limited partnerships, which was to trade commodities. Instead Douglas caused the corporations to pay out the money they received to himself, his ex-wife, his favorite charities, and an investor, Phillips, whom Douglas wanted to keep happy, no doubt in the hope that Phillips would invest more money in the Ponzi scheme or encourage others to do so. In the case of the ex-wife, the money went from the corporations first to Douglas and then from him to her, but we cannot see what difference that should make. If the money stopped with Douglas, a certain awkwardness might arise from the fact that Scholes is the receiver both for Douglas and for the corporations which would be suing him for that money. But that is not our case and we need not consider it.

[4] The three sets of transfers removed assets from the corporations for an unauthorized purpose and by doing so injured the corporations. As sole shareholder, Douglas could lawfully have ratified the diversion of corporate assets to noncorporate purposes--but only if

creditors were not harmed. Steinberg v. Buczynski, *supra*, 40 F.3d at 892; Dannen v. Scafidi, 75 Ill.App.3d 10, 30 Ill.Dec. 899, 903, 393 N.E.2d 1246, 1250 (1979). Creditors were harmed. The limited partners were tort creditors of the corporations from which they had been inveigled into buying limited-partner interests, and were, of course (other than Phillips), harmed. "It was not within the power of the shareholders to legalize this waste to the detriment of others." McCandless v. Furlaud, 296 U.S. 140, 160, 56 S.Ct. 41, 47, 80 L.Ed. 121 (1935) (Cardozo, J.).

[5] Though injured by Douglas, the corporations would not be heard to complain as long as they were controlled by him, not only because he would not permit them to complain but also because of their deep, their utter, complicity in Douglas's fraud. The rule is that the maker of the fraudulent conveyance and all those in privity with him--which certainly includes the corporations--are bound by it. Getty v. Hunter, 166 Ill.App.3d 453, 116 Ill.Dec. 825, 827, 519 N.E.2d 1040, 1042 (1988); Peric v. Chicago Title & Trust Co., 89 Ill.App.3d 271, 44 Ill.Dec. 568, 411 N.E.2d 934 (1980). But the reason, of course, as the cases just cited make clear, is that the wrongdoer must not be allowed to profit from his wrong by recovering property that he had parted with in order to thwart his creditors. That reason falls out now that Douglas has been ousted from control of and beneficial interest in the corporations. The appointment of the receiver removed the wrongdoer from the scene. The corporations were no more Douglas's evil zombies. Freed from his spell they became entitled to the return of the moneys--for the benefit not of Douglas but of innocent investors--that Douglas had made the corporations divert to unauthorized purposes. McCandless v. Furlaud, *supra*, 296 U.S. at 159-61, 56 S.Ct. at 47; Texas & Pacific Ry. v. Pottorff, 291 U.S. 245, 260-61, 54 S.Ct. 416, 420, 78 L.Ed. 777 (1934); Southmark Corp. v. Cagan, 999 F.2d 216, 222 (7th Cir.1993). That the return would benefit the limited partners is just to say that anything that helps a corporation helps those who have claims against its assets. The important thing is that the limited partners were not complicit in Douglas's fraud; they were its victims.

Put differently, the defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated. \*755McCandless v. Furlaud, *supra*, 296 U.S. at 160, 56 S.Ct. at 47; Albers v. Continental Illinois Bank & Trust Co., 296 Ill.App. 596, 17 N.E.2d 67 (1938). Now that the corporations created and initially controlled by Douglas are controlled by a receiver whose only object is to maximize the value of

the corporations for the benefit of their investors and any creditors, we cannot see an objection to the receiver's bringing suit to recover corporate assets unlawfully dissipated by Douglas. We cannot see any legal objection and we particularly cannot see any practical objection. The conceivable alternatives to these suits for getting the money back into the pockets of its rightful owners are a series of individual suits by the investors, which, even if successful, would multiply litigation; a class action by the investors--and class actions are clumsy devices; or, most plausibly, an adversary action, in bankruptcy, brought by the trustee in bankruptcy of the corporations if they were forced into bankruptcy. Concerning this last alternative, it is true that investors, including limited partners in a corporation's investment fund, are not contractual creditors of the corporation, Allen v. Amber Manor Apartments Partnership, 95 Ill.App.3d 541, 51 Ill.Dec. 26, 32, 420 N.E.2d 440, 446 (1981); In re Dutch Inn of Orlando, Ltd., 614 F.2d 504 (5th Cir.1980) (per curiam), any more than the corporation's stockholders are. But *defrauded* investors, as we have pointed out, are tort creditors. So Douglas's corporations were insolvent from the outset and could have been petitioned into bankruptcy. Corporate bankruptcy proceedings are not famous for expedition, however; and whatever advantages they may have over receiverships in a case such as this--if any, and none has been pointed out to us--are not ones that the defendants in these fraudulent conveyance actions should be heard to trumpet. Bankruptcy is for the protection of debtors and creditors, and so far as appears no debtors or creditors connected with Douglas's enterprise prefer the bankruptcy route to the receivership route.

We add that if in place of the receiver's actions the investors had brought a class action against the present defendants, or had sued them individually, the defendants would no doubt be arguing that the action was improper because the injury was to the corporations and only derivatively to investors in the corporations. Hammes v. AAMCO Transmissions, Inc., 33 F.3d 774, 777 (7th Cir.1994); Kagan v. Edison Bros. Stores, 907 F.2d 690 (7th Cir.1990); Manson v. Stacescu, 11 F.3d 1127, 1131 (2d Cir.1993).

We need not consider whether if Douglas had operated as a sole proprietorship rather than through corporations or other legally distinct entities, the receiver could still have maintained these suits. It could be argued, RICO-fashion, that the Ponzi scheme was a "Douglas enterprise" that Douglas caused to dissipate assets received by the enterprise for investment purposes. We need not decide how good

an argument it is, and merely add that we can find no cases in which a receiver for a sole proprietorship recovered a fraudulent conveyance.

So these are proper suits and the next question is whether the transfers should be deemed to fall outside the statute because they were supported by sufficient consideration. Begin with the transfer to Phillips. He invested some \$2.5 million in Douglas's scheme, all innocently we may assume, and by exceptional good fortune netted almost \$300,000 on his investment. This profit, more precisely the expectation of this profit, was in consideration of Phillips's entrusting his money to Douglas's corporations. Douglas's ex-wife might be able to show that some of the transfers made to her were supported by consideration in the form of a discharge of Douglas's legal obligations to her--obligations of child support and the like arising from their divorce. In the case of the religious associations, which are charitable organizations, it may seem obvious that since charitable *pledges* are often found or deemed to be supported by consideration and therefore legally enforceable, Allegheny College v. National Chautauqua County Bank, 246 N.Y. 369, 159 N.E. 173 (1927) (Cardozo, J.); King v. Trustees of Boston University, 420 Mass. 52, 647 N.E.2d 1196 (1995); 1 E. Allan Farnsworth, Contracts § 2.19 (1990), so must the actual *donation* to the charity. There is support for this proposition, Dunaway v. First Presbyterian Church, 103 Ariz. 349, 442 P.2d 93, 95 (1968), but only in the case, which this is not, where the donor is seeking to \*756 enforce a condition in his gift. A promise of a gift is a promise nonetheless, and so is a promise to the donor to abide by a condition in the gift; and the enforcement of promises is the office of contract law. The gift itself is not a promise, however; it is a gift. United States v. American Bar Endowment, 477 U.S. 105, 118, 106 S.Ct. 2426, 2433, 91 L.Ed.2d 89 (1986).

The statute under which the receiver sued does not say that transfers supported by consideration are outside its reach. It does not have to. A transfer for full in the sense of commensurate consideration cannot (in the ordinary case, anyway) hinder, defraud, or otherwise discomfit creditors, because it is merely replacing one asset with another of equivalent value, as with revolving credit. The point is explicit in the new statute. It states in language virtually identical to the corresponding provision in the Bankruptcy Code, 11 U.S.C. § 548(a)(2), that a transfer will be deemed fraudulent if the debtor made it "without receiving a reasonably equivalent value in exchange for the transfer." 740 ILCS 160/5(a)(2). The transfer must also, under the new statute as under the old, endanger

