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Recent Updates to the Uniform Fraudulent Transfer Act

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FRAUDULENT CONVEYANCE LAW
RECENT DEVELOPMENTS

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I. General Provisions

Fraudulent transfers in bankruptcy may be avoided based on the application of federal bankruptcy law, set forth in 11 U.S.C. § 548, or through relevant state law made applicable in bankruptcy under 11 U.S.C. § 544(b). Typically, the state law is the version of the Uniform Fraudulent Transfer Act ("UFTA") enacted in the state whose law applies.

Generally, there are two types of avoidable fraudulent transfers – those based on actual fraud, and those which are constructively fraudulent.

1. Actual Fraud

a. 11 U.S.C. § 548(a)(1)(A): "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 2 years before the date of the filing of the petition if the debtor voluntarily or involuntarily . . . made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date such transfer was made or such obligation was incurred, indebted[.]"

b. 11 U.S.C. § 544(b) and UFTA § 4(a)(1): Similar standard, typically with a 4 or 6-year look-back period.

c. 11 U.S.C. § 548(e): A trustee "may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if . . . such transfer was made to a self-settled trust or similar device" by the debtor and the debtor is a beneficiary of the trust, and "the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that transfer was made, indebted."

2. Constructive Fraud

a. 11 U.S.C. § 548(a)(1)(B): "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 2 years before the date of the filing of the petition if the debtor voluntarily or involuntarily . . . received less than reasonably equivalent value in exchange for such transfer or obligation; *and*"

- was insolvent on the date of the transfer/obligation or became insolvent as a result thereof;
- was engaged/about to engage in business or a transaction for which any property remaining with the debtor was unreasonably small capital;

- intended to incur/believed that would incur, debts that would beyond the debtor's ability to pay on maturity; *or*
- made such transfer or incurred such obligation to or for the benefit of an insider under an employment contract and not in the ordinary course of business.

b. 11 U.S.C. § 544(b) and UFTA § 4(a)(2): Similar standards, typically with a 4 or 6-year look-back period.

c. 11 U.S.C. § 548(b): Transfers or obligations made on or within 2 years of the petition date to a general partner in a partnership debtor are avoidable if the debtors was insolvent at the time of or became insolvent as a result of the transfer or obligation.

3. Exemptions/Defenses

a. Religious/Charitable--11 U.S.C. § 548(a)(2) and (d)(3): Transfers/obligations to religious and charitable entities by natural persons are not avoidable.

b. Good Faith Transferees--11 U.S.C. § 548(c): If a transferee takes "for value and in good faith" it has "a lien on or may retain any interest transferred or may enforce any obligation incurred . . . to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation." Similar provisions exist under the UFTA.

c. Securities Contracts Safe Harbor—11 U.S.C. § 546(e): Certain transfers that are "settlement payments" made in connection with a securities contracts are immune from avoidance, unless the transfer was made with actual intent to hinder, delay or defraud creditors.

d. UFTA Defenses: Independent defenses may exist under the applicable version of the UFTA. Many states have provisions making "reasonably equivalent value" and good faith a defense to avoidance of a transfer that would otherwise be avoidable based on actual fraud. In 2015, the Utah legislature amended the UFTA to expand the avoidance of certain types of otherwise constructively fraudulent transfers.

4. Statute of Limitations

a. 11 U.S.C. § 546(a): Avoidance actions under 11 U.S.C. §§ 544(b) and 548 may not be brought after the earlier of the time the case is closed or dismissed, or the later of two years after the entry of the order for relief or one year after the appointment or election of the first trustee in the case if that appointment or election occurs before the expiration of two year period.

b. UFTA: If a fraudulent transfer is being pursued outside of bankruptcy, the applicable state statute of limitations will apply.

5. Recovery

a. Avoidance of a transfer is different than the ability to recover the judgment.

b. 11 U.S.C. § 550: This provision governs recovery of avoided transfers from "initial transferees" as well as "immediate or mediate transferees" of the initial transferee. Immediate or mediate transferees are entitled to a good faith defense. *See id.* §550(b). An action to recover an avoided transfer must be brought by the earlier of one year after avoidance or the time the bankruptcy case is closed or dismissed. *Id.* § 550(f)

c. State Law: If avoiding a transfer under § 544(b) and state law, recovery is governed by the applicable version of the UFTA.

II. Interest of the Debtor in Property

1. General

Section 548 refers transfers of "an interest of the debtor in property." This is typically interpreted to mean property of the estate under 11 U.S.C. § 541(a).

2. Recent Cases of Interest

a. *Gladstone v. U.S. Bancorp*, 811 F.3d 1133 (9th Cir. 2016): Debtor's interest in term life insurance policies was an interest of the debtor in property. Thus, the debtor's transfer of his interests in those policies several months prior to the filing of his Chapter 7 case for approximately $507,000 was avoidable as a fraudulent transfer because he received less than reasonably equivalent value in exchange for those interests. The interests were worth at least $1 million and the purchasers of the interests were in fact paid $9 million when the debtor died several months after the petition date.

b. *Scott v. King (In re Amerson*), 839 F.3d 1290 (10th Cir. 2016): A debtor's interest in a spendthrift trust created by her late father was property of the estate, notwithstanding 11 U.S.C. § 541(c)(2). The exclusion of such trusts from the estate is permissive and not mandatory, and the debtor had waived the protection of § 541(c)(2). The waiver was a result of inclusion of her interest in a probate contest in her schedules and her failure to argue the application of § 541(c)(2).

c. *Davis v. Hoa Thi Pham (In re Nguyen),* 783 F.3d 769 (10th Cir. 2015): Bare legal title is not an interest in property that may be avoided under 11 U.S.C. § 548(a)(1)(B).

d. *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013): Under 11 U.S.C. § 541(a)(1) property of the estate does not include fraudulently transferred property until that property is recovered. Thus, transferee's use of proceeds of sale of transferred property was not enjoined by the automatic stay. *Compare Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.),* 714 F.2d 1266 (5th Cir. 1983).

e. *Rupp v. Moffo*, 358 P.3d 1060 (Utah 2015): A debtor-landlord's agreement to allow tenant to reside in a home rent-free was not subject to avoidance under 11 U.S.C. § 544(b) and the Utah UFTA. The home in which the tenant resided was fully encumbered by a mortgage and any rents that might have been owed were never property of the bankruptcy estate, but rather payable to the lender.

III. Actual Fraud--Badges of Fraud/Ponzi Presumption

1. General

Fed. R. Civ.P 9(b), made applicable in bankruptcy by Fed. R. Bankr. P. 7009, requires the plaintiff to allege facts that give rise to a strong inference of fraudulent intent. This may be established by facts showing "either (1) a motive and opportunity to commit fraud; or (2) strong circumstantial evidence of conscious misbehavior or recklessness." *Wisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 554 B.R. 635, 652 (S.D.N.Y. 2016) (internal quotations omitted). In meeting this standard, courts typically allow the plaintiff to rely on "badges of fraud" to infer actual intent to hinder, delay or defraud creditors. *Id*. These badges of fraud stem from the rule in *Twyne's Case*, 3 Coke 80b, 76 Eng. Rep. 809 (1601).

Many states have adopted provisions of the UFTA that actually contain a non-exclusive list of badges of fraud. *See, e.g.*, *In re Taylor*, 133 F.3d 1336 (10th Cir. 1998), interpreting Utah Code Ann. § 25-6-5(2). That section states that in determining "actual intent . . . , consideration may be given, among other factors, to whether"

- the transfer or obligation was to an insider;
- the debtor retained possession or control of the property transferred;
- the transfer or obligation was disclosed or concealed;
- before the transfer/obligation was made, the debtor was sued or threatened with suit or became obligated on a substantial debt;
- the transfer was of substantially all of the debtor's assets;
- the debtor absconded;
- the debtor removed or concealed assets;
- the value of the consideration received;
- the solvency of the debtor; and

- convoluted transfer schemes where the assets ultimately are held by an insider.

2. Husky

In *Husky Int'l Electronics, Inc. v. Ritz*, 136 S.Ct. 1581 (2016), the Court discussed the need for a false representation to prove actual fraud for nondischargeability purposes. Holding that "actual fraud" under 11 U.S.C. § 523(a)(2)(A) encompasses frauds that do not include a false representation, the Court stated that, indeed, fraud encompasses fraudulent conveyances that do not require a debtor's misrepresentation. Concealment and hindrance of the collection of a debt are enough to establish actual fraud.

3. Actual Fraud Standard

In *Wisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 554 B.R. 635, 651-52 (S.D.N.Y. 2016), the district court recently discussed standards for alleging transfers made with an intent to hinder, delay or defraud. The court stated that the following are important for an allegation of actual fraud:

- A debtor's actual intent to defraud need not target a particular entity or individual as long as intent is directed toward present or future creditors of the debtor.
- The intent must be more than just giving a preference to one creditor over another.
- Intent to interfere with "creditors' normal collection processes or with other affiliated creditor rights for personal or malignant ends."
- The debtor/transferor must have a "mental apprehension" of the consequences of its act and be "substantially certain" of the result.

4. Imputing Fraudulent Intent

In *Wisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 554 B.R. 635, 647 (S.D.N.Y. 2016), the district court held that a corporate CEO's intent could be imputed to the debtor/transferor under Delaware law where the CEO was acting within his authority and even where his acts were fraudulent or illegal. The district court held that the bankruptcy court's decision limiting imputation of intent only in situations where an officer controls the board was incorrect. It distinguished cases in which the transferee's intent is imputed to a corporate debtor/transferor. *Id*. at 649 (citing cases). See *Wisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 2016 U.S. Dist. LEXIS 138449 (S.D.N.Y. filed Oct. 5, 2016)(denying petition for reconsideration and for certification pursuant to 28 U.S.C. § 1292(b)).

5. Ponzi Presumption

Ponzi schemes give rise to the "Ponzi presumption" as a badge of fraud. The presumption holds that all transfers made by the entity engaged in the Ponzi scheme are committed with actual intent to hinder, delay or defraud its creditors. *See Klein v. Cornelius (In re Winsome Invest. Trust)*, 786 F.3d 1310 (10th Cir. 2015). "And because Ponzi schemes are

insolvent by definition, we presume that transfers from such entities involve actual intent to defraud." *Id*. at 1320.

Recent Cases of Interest

a. *Golf Channel Cases:* The Golf Channel, Inc. ("GC") received almost $6 million in fees for advertising sold to the Stanford Group – a Ponzi scheme. The receiver sued GC, arguing that payments to it for advertising services were avoidable fraudulent transfers as not having been made for reasonably equivalent value. The district court rejected this view, holding that GC provided value and that the GC was an innocent trade creditor. The Fifth Circuit reversed, stating that while advertising services" may have been quite valuable to the creditors of a legitimate business, they have no value to the creditors of a Ponzi scheme. . . . Services rendered to encourage investment in such a scheme do not provide value to the creditors" because they only prolong the fraud and increase innocent investors' losses. *Janvey v. Golf Channel, Inc*., 780 F.3d 641, 646 (5th Cir. 2015). On rehearing *en banc*, the panel withdrew its opinion and asked the Texas Supreme Court to advise whether the Texas UFTA requires proof of "reasonably equivalent value" from the perspective of creditors, or whether the defendant can defeat a fraudulent transfer claim by showing it provided goods or services at market value. The Texas Supreme Court held that "reasonably equivalent value" is provided under Texas UFTA when (1) services were fully provided under an arms'-length contract for "fair market value," (2) the consideration had "objective value" and (3) the exchange occurred in the ordinary course of the defendant's business. *Janvey v. Golf Channel, Inc.*, 487 S.W.3d 560 (Tex., 2016). In the context of a Ponzi scheme, the Court said that value is provided so long as the services would have been available to another buyer at market rates had they not been purchased by the Ponzi scheme. From the perspective of a reasonable creditor, the Court stated the advertising services had value even if they depleted the Ponzi scheme's estate. Based on this holding, the Fifth Circuit reversed its prior conclusion and affirmed the district court's grant of summary judgment in favor of GC. *Janvey v. Golf Channel, Inc.*, 834 F.3d 570 (5th Cir. 2016). But, the court limited this decision, observing that "TUFTA is unique among fraudulent transfer laws because it provides a specific market-value definition of 'reasonably equivalent value.'" *Id*. at 573. The court also stated that its prior decisions to the contrary under § 548 retain their "binding effect," as do Fifth Circuit opinions interpreting other states' fraudulent transfer laws, and that the "primary consideration" is "the degree to which the transferor's net worth is preserved." *Id.* The question is not whether the consideration had "objective value," but whether the exchange "conferred a tangible economic benefit on the debtor." *Id.*

b. *Klein v. Cornelius (In re Winsome Invest. Trust)*, 786 F. 3d 1310 (10th Cir. 2015): An equity receiver for a Ponzi scheme sought to recover $90,000 in legal fees paid by the enterprise on behalf of a friend of the perpetrator. It was uncontested that the law firm had no involvement in or knowledge of the fraud and was an innocent initial transferee of the funds. The Tenth Circuit held that the payments were avoidable, stating: "Nothing in the [Utah version of the] UFTA requires that a transferee be aware of the

fraud." *Id*. at 1321. Because Ponzi schemes are insolvent by definition, the court presumed that transfers from such entities involve actual intent to defraud.

c. *Finn v. Alliance Bank*, 860 N.W.2d 638 (Minn. 2015): The Minnesota Supreme Court rejected the Ponzi scheme presumption, saying that the Minnesota Uniform Fraudulent Transfer Act does not mention Ponzi schemes and is focused on individual transfers, not schemes. "The asset-by-asset and transfer-by-transfer nature of the inquiry under MUFTA requires a creditor to prove the elements of a fraudulent transfer with respect to each transfer, rather than relying on a presumption related to the form or structure of the entity making the transfer." *Id.* at 647.

d. *In re ZeekRewards*, Case No. 14-cv-91 (W.D.N.C.): In this Ponzi scheme, the equity receiver filed a class action lawsuit against 9,400 domestic "net winners", seeking to avoid and recover false profits under the North Carolina version of the UFTA. The district court certified the class, and named 19 of the larger net winners as class representatives. Summary judgment was ultimately granted to the receiver (filed Nov. 29, 2016).

IV. Constructive Fraud--Reasonably Equivalent Value

1. General

a. Constructively fraudulent transfers must lack "reasonably equivalent value".

b. Section 548(d)(2) defines "value" as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to finish support of the debtor or to a relative of the debtor."

c. Similar provisions typically exist in applicable provisions of the UFTA.

d. Fair market value" is an important element of reasonably equivalent value, but it is not the same. *See BFP v. Resolution Trust Corp.,* 511 U.S. 531 (1994). IRS Revenue Ruling 59-60 defines "fair market value" as the amount at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell and both parties have reasonable knowledge of the relevant facts.

2. Recent Cases of Interest

a. *Klein v. Cornelius (In re Winsome Invest. Trust)*, 786 F. 3d 1310 (10th Cir. 2015): A payment made solely for the benefit of a third party, such as a payment to satisfy a third party's debt, does not provide "reasonably equivalent value" with the

meaning of the Utah UTFA's defense to actually fraudulent transfers. The court quoting several sources ruled that "reasonably equivalent value" is measured by the "degree to which the transferor's net worth is preserved." *Id* at 1321.

b. *Deutsche Bank Trust Co. Americas v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2nd Cir. 2016), *pet. for cert*, No. 16-317 (S.Ct. filed Sept. 9, 2016): A fraudulent transfer action brought under 11 U.S.C. § 544(b) is a claim arising under federal law. If an action is not commenced prior to the expiration of the statute of limitations under 11 U.S.C. § 546(a), the claims do not revert to creditors to be brought under the applicable version of the UFTA.

c. *Klein v. McDonald (In re National Note of Utah, LC),* No. 13-cv-803 (D. Utah filed June 18, 2015): False profits (*i.e*., amounts paid out of a Ponzi scheme in excess of an investor's actual cash investment) cannot constitute reasonably equivalent value.

d. *Klein v. Turpin, et al. (In re National Note of Utah LC),* No. 14-cv-302 (D. Utah filed July 14, 2015): Law firm, which provided legal services to owner of Ponzi scheme company prior to its collapse but was paid by the company, did not provide "value" to the company within the meaning of Utah UFTA, therefore transfers from company to firm were fraudulent.

e. *Tracht Gut, LLC. V. Los Angeles County Treasurer & Tax Collector et al. (In re Tracht Gut, LLC),* 836 F.3d 1146 (9th Cir. 2016): Applying *BFP v. Resolution Trust Corp.,* 511 U.S. 531 (1994) to California tax sale of property and holding that properly conducted sale was a transaction that produced "reasonably equivalent value." Compare *In re Smith*, 811 F.3d 228 (7th Cir. 2016): tax sale did not produce "reasonably equivalent value" because auction procedure for bidding lowest amount acceptable to pay delinquent taxes bore no relationship to the value of the property.

f. *DeGiacomo v. Sacred Heart Univ. (In re Palladino*), 556 B.R. 10 (Bankr. D. Mass. 2016): Insolvent parents payment of daughter's undergraduate tuition was not constructively fraudulent. Parents could reasonably expect that an educated child will confer an economic benefit on them.

V. Statute of Limitations

Recent Cases of Interest

a. *Bash v. Textron Fin. Corp. (In re Fair Finance Co.)*, 834 F.3d 651 (6th Cir. 2016): Applying the Ohio version of the UFTA, the statute of limitations begins to run when the fraudulent nature of a transfer is discoverable, not the date that the transfer is discoverable. The purpose of the UFTA is to discourage fraud and provide recovery for

defrauded creditors. Timing the discovery period from the time of the transaction would reward those who conceal fraud.

b. *Gladstone v. U.S. Bancorp*, 811 F.3d 1133 (9th Cir. 2016): When the statute of limitations on recovery of a fraudulent conveyance is tolled because the debtor has concealed facts from the trustee, it is tolled even as to trustee's claims against innocent transferees who had no part in the concealment.

c. *Klein v. Cornelius (In re Winsome Invest. Trust)*, 786 F. 3d 1310 (10th Cir. 2015): The statute of limitations under the Utah version of the UFTA on recovery of transfers from a Ponzi scheme is tolled for so long as the scheme is controlled by the wrongdoers.

d. *Mukamal v. Citibank (In re Kipnis),* 555 B.R. 877 (Bankr. S.D. Fla. 2016): Chapter 7 trustee empowered under § 544(b) to step into the shoes of the IRS and pursue fraudulent conveyance avoidance action occurring up to 10 years pre-petition.

VI. Extraterritorial Reach

Weisfelner v. Blavatnik (In re Lyondell Chem. Co.), 543 B.R. 127 (Bankr. S.D.N.Y. 2016): Recognizing a split in authorities, the court held that 11 U.S.C. §§ 541, 548 and 550, when read together, show Congressional intent to apply § 548 to extraterritorial transfers.

VII. Defenses/Recovery

Recent Cases of Interest

a. *FTI Consulting, Inc. v. Merit Mang. Group LP*, 830 F.3d 690 (7th Cir. 2016): The safe harbor defense to fraudulent transfer actions in 11 U.S.C. § 546(e) does not apply where the financial intuition is a mere conduit and received no benefit from the transaction. This decision is a departure from other Circuit court decisions.

b. *Deutsche Bank Trust Co. Americas v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2nd Cir. 2016), *pet. for cert*, No. 16-317 (S.Ct. filed Sept. 9, 2016): Safe harbor provision in 11 U.S.C. § 546(e) may be extended to UFTA actions. The court held that transfers made in connection with an LBO were immune from avoidance, stating § 546(e) "clearly covers payments . . . by commercial firms to financial intermediaries to purchase shares from the firm's shareholders," and rejected that that section does not apply "when monetary damages are sought only from shareholders, or an LBO is involved. *Id.* at 120. See *Wisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 554 B.R. 635, 647 (S.D.N.Y. 2016) (similar claims for constructive fraudulent transfer claims dismissed in light of the *Tribune* case).

c. *In re Smith*, 811 F.3d 228 (7th Cir. 2016): Chapter 13 debtors who avoided a tax sale transfer under 11 U.S.C. §§ 522(h) and 548 where homestead was sold for $5,000 and then resold for $50,000, were limited to recovery of their $15,000 exemption, not the entire $45,000. *See Moore v. Bay*, 284 U.S. 4 (1931) (avoidable fraudulent transfer is set aside entirely and is not limited).

d. *Klein v. M&M Andreasen Invs., Inc., et al. (In re National Note of Utah LC),* No. 13-cv-462 (D. Utah filed April 26, 2016): Avoidable false profits paid by Ponzi scheme to corporation were recoverable from owners because corporation was a mere conduit.

e. *Brandt v. Horseshoe Hammond, LLC (In re Equip. Acquisition Res. Inc.),* 803 F.3d 835 (7th Cir. 2015): A casino that accepted money from the debtor's controlling shareholder who looted the corporation for several million dollars, was not liable as an intermediate transferee under § 550(b)(1) where it accepted the transfers in good faith and without knowledge of their voidability.