AMERICAN BANKRUPTCY INSTITUTE

2022 Winter Leadership Conference

UFTA/UVTA Issues

Hosted by the Commercial Fraud and Legislation Committees

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CONCURRENT SESSION

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AMERICAN BANKRUPTCY INSTITUTE
WINTER LEADERSHIP CONFERENCE

Emerging Issues and Challenges under the UVTA

Speakers

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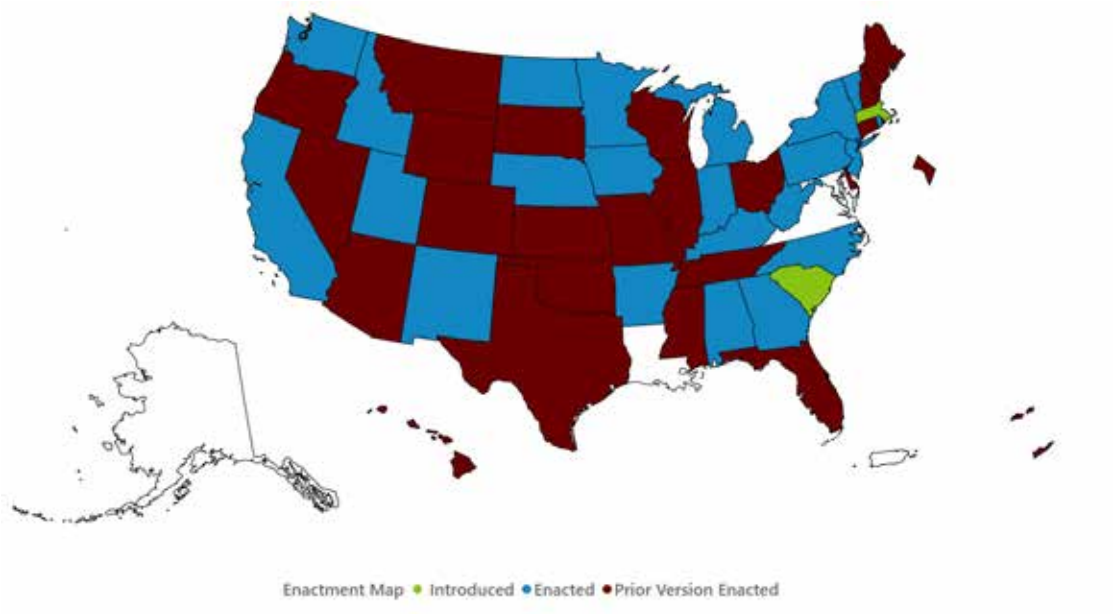
Emerging Issues and Challenges under the UVTA

Enactment of "UVTA"

- Promulgated by the ULC in 2014
- Not a wholesale rewriting of the UFTA
- Changes are narrow, targeted, and intended to clarify points of confusion and harmonize law with other statutes
- 22 States have enacted the UVTA
- Recently introduced in MA & SC



RECAP: 4 general types of voidable transactions under the UFTA/UVTA

- Transfers made with actual intent to hinder, delay, or defraud creditors;
- Transfers made by an insolvent debtor without receiving reasonably equivalent value in exchange for the transfer;
- Transfers made by an insolvent debtor to an insider of the debtor that has reasonable cause to believe that the debtor is insolvent; and
- Transfers made by a debtor, without receiving reasonably equivalent value in exchange for the transfer, when the debtor is either undercapitalized or about to incur debts beyond his ability to pay as they become due.

Summary of UVTA's Changes to the UFTA

1. Changes to Verbiage
2. Adds Choice of Law Provision
3. Adds Burden Proof Provision
4. Refines the Definition of Insolvency
5. Refines Certain Defenses
6. Addresses Series Organizations

(1) Changes in verbiage

UFTA	UVTA
• "***Fraudulent***"	• "***Voidable***"
• "***Transfers***"	• "***Transactions***"

"Voidable" intended to discourage application of erroneous intent element by courts and parties

"Transfer" was considered underinclusive because it failed to cover the incurrence of obligations by the debtor

(2) Choice of Law

- UVTA Claims are governed by the law of the jurisdiction in which debtor is "located" at time of the transfer
- "Located":
  - **Individual:** principal residence
  - **Organization:** its place of business
  - **Organization with more than one POB**: chief executive office
- Analogous to section 9-301 of UCC
- Simple, predictable rule; discourages forum shopping

(3) Burden of Proof

- Generally, the creditor has burden of proving UVTA claims
- Generally, the transferee has burden of proving UVTA defenses
- Standard of Proof: simple "***preponderance of evidence***" standard
- UVTA rejects heightened "clear and convincing evidence" standard, even if "actual intent to defraud" is alleged

(4) Insolvency

- Debtor is insolvent "*if the sum of debtor's debts* ***at fair valuation*** *is greater than the sum of debtor's assets at fair valuation*"
- Special definition of insolvency for partnerships is DELETED
- Presumption of Insolvency: A debtor who is generally not paying debts as they come due is ***presumed*** insolvent
- If the presumption is triggered, the burden shifts to defendant (i.e., transferee) to prove Debtor was solvent

(5) Refinement of Defenses

- **Under Section 8(a) Good Faith/REV are a Complete Defense to claim based on "actual intent" provided the REV goes to the Debtor**
  - UFTA made it a complete defense to transfers "made with actual intent to hinder, delay, defraud creditors" if the transferee takes in good faith and for reasonably equivalent value
  - UVTA clarifies that the reasonably equivalent value must be given ***to the debtor***

(5) Refinement of Defenses

- **Clarifies protections for "Subsequent Transferees" Under Section 9(b) of the UVTA**
  - UVTA retains UFTA's complete defense for subsequent transferees (i.e., transferees other than the first transferee) that take in good faith and for value
  - Section 9(b) UVTA also protects any subsequent transferee who takes in good faith from a ***protected*** transferee, ***even if the subsequent transferee did not take for value***

(5) Refinement of Defenses

- **Section 8(e)(2) of the UVTA excludes "strict foreclosure" from the safe harbor for Article 9 remedies**
  - UVTA retains UFTA "safe harbor" language providing that transfers resulting from enforcement of a security interest under Article 9 or a non-collusive mortgage foreclosures are not avoidable.
  - UVTA carves out "acceptance of collateral in full or partial satisfaction of the obligation it secures" under Article 9- aka "strict foreclosure."

(6) Series Organizations

- UVTA adds new section providing that a "series organization" and each "series of the organization" is to be treated as a separate person for purposes of the Act, even if not treated as a person for other purposes.
- Recognition of the increasing prevalence of series organizations in complex transactions
- Series organization may not be a legal entity, even though it has own assets and liabilities, and if not legal entity, creditor could not challenge a transfer of property from one series to another under fraudulent transfer law, which applies only to a "person" (i.e., a legal entity)
- UVTA seeks to close this loophole by treating "series" as a person

AIDING AND ABETTING/CONSPIRACY LIABILITY FOR FRAUDULENT TRANSFERS?

Restatement Definition of Aiding and Abetting:
A defendant is subject to liability for aiding and abetting a tort upon proof of the following elements:

(a) a tort was committed against the plaintiff by another party;
(b) the defendant knew that the other party's conduct was wrongful;
(c) the defendant knowingly and substantially assisted in the commission or concealment of the tort; and
(d) the plaintiff suffered economic loss as a result.

Restatement (Third) of Torts: Liab. for Econ. Harm § 28 (2020).

Restatement Definition of Conspiracy:
A defendant is subject to liability for conspiracy to commit a tort upon proof of the following elements:
(a) the defendant made an agreement with another to commit a wrong;
(b) a tortious or unlawful act was committed against the plaintiff in furtherance of the agreement; and
(c) the plaintiff suffered economic loss as a result.

Restatement (Third) of Torts: Liab. for Econ. Harm § 27 (2020).

Application to claims for Fraudulent Transfers:

- *Aghaian v. Minassian*, 59 Cal. App. 5th 447, 459, 273 Cal. Rptr. 3d 561, 570 (2020) (recognizing claim for aiding and abetting fraudulent transfer), reh'g denied (Jan. 25, 2021), review denied (Apr. 14, 2021).

- *Firstar Bank, N.A. v. Faul*, No. 00 C 4061, 2001 WL 1636430, at *6 (N.D. Ill. Dec. 20, 2001) (Recognizing that Illinois law permits a cause of action for fraud against any party who participates in a fraud and concluding that it sees "reason not to extend this rule to fraudulent conveyances").

- *Lowell Staats Mining Co. v. Phila. Elec. Co.*, 878 F.2d 1271, 1276 n. 1 (10th Cir.1989) (declining to extend UFTA to find "aiding and abetting" liability against an agent of the corporation, where it seems the agent was not an officer, director or shareholder).

- *Mack v. Newton*, 737 F.2d 1343, 1361 (5th Cir.1984) (declining to extend UFTA to individuals who participated in a conspiracy to commit a fraudulent transfer).

- *Thompson Kernaghan & Co. v. Global Intellicom, Inc.*, No. 99 CIV. 3005(DLC), 1999 WL 717250, at *2 (S.D.N.Y. Sept.14, 1999) (declining to apply an accessory liability theory to a lawyer of "first transferee" who helped set up the corporation involved).

Opinions from Two State Supreme Courts (under the UFTA):

Florida Supreme Court:

Freeman v. First Union Nat. Bank, 865 So. 2d 1272, 1276 (Fla. 2004).

Rejecting aiding and abetting liability for claims under the UFTA by interpreting the catch-all provision of the remedies section of the statute and finding that the legislature did not intend to create a new cause of action through the enactment of the FUFTA:

> Although the FUFTA statutory scheme provides a "catch-all" phrase that allows courts to award "other relief," we believe that the Legislature intended it to facilitate the use of the other remedies provided in the statute, rather than creating new and independent causes of action such as aider-abettor liability, as the appellants argue.

Nevada Supreme Court:

Cadle Co. v. Woods & Erickson, LLP, 131 Nev. 114, 119, 345 P.3d 1049, 1053 (2015).

Followed Florida in rejecting aiding and abetting liability under the UFTA and agreed with the Florida' Court's reasoning but added an additional reason for rejecting the theory of liability:

> Furthermore, it does not make sense to apply an equitable remedy, voiding a transfer of property, against a party who never had possession of the transferred property. First, the third party has no control over the property and, therefore, cannot return it to the creditor. Second, once a creditor is made whole by a successful action against the transferor or transferee, he is no longer in need of an equitable remedy against a third party. True, NRS 112.210(1) permits creditors to obtain "any other relief the circumstances may require." But we agree with other jurisdictions that this language, taken from the Uniform Fraudulent Transfer Act, "was intended to codify an existing but imprecise system," not to create a new cause of action.

Did the clarification to the UVTA change the analysis?

UVTA Section 15. Comment 5.
The Act does not address the extent to which a person who facilitates the making of a transfer or the incurrence of an obligation that is voidable under the Act may be subject to liability for that reason, whether under a theory of aiding and abetting, civil conspiracy, or otherwise. The Act leaves that subject to supplementary principles of law. See § 12. Cf. § 8(b)(1)(i) (imposing liability upon, inter alia, "the person for whose benefit the transfer was made"). Other law also governs such matters as (i) the circumstances in which a lawyer who assists a debtor in making a transfer or incurring an obligation that is voidable under the Act violates rules of professional conduct applicable to lawyers, (ii) the circumstances in which communications between the debtor and the lawyer in respect of such a transfer or obligation are excepted from attorney-client privilege, and (iii) the extent to which criminal sanctions apply to a debtor, transferee, obligee, or person who facilitates the making of a transfer or the incurrence of an obligation that is voidable under the Act. Neither the retitling of the Act, nor the consistent use of "voidable" in its text per Comment 4, effects any change in the meaning of the Act, and those amendments should not be construed to affect any of the foregoing matters.

Examples of Potential Claims:

Example 1: Accountant hired by PE firm to provide a solvency opinion for one the firm's portfolio company in advance of issuing a divided. The accountant provides an

opinion that the company is solvent despite having knowledge that (1) the company is, in fact, insolvent; (2) its opinion would be used to justify the issuance of a dividend that would constitute a fraudulent transfer under the UVTA.

Example 2: Lawyer hired by judgement debtor to devise an asset protection plan to prevent his judgement creditor from obtaining his assets. Lawyer draft plan, creates entities, and executes plan on behalf of judgment debtor.

The Problem of Fraudulent (Voidable) Transfer (Transaction) Recovery in an estate with fully encumbered assets.

By: Patricia A. Redmond and Dominick Serio

Under the Uniform Fraudulent Transfer Act ("UFTA"), any transfer made or obligation incurred, by a debtor with "actual intent to hinder, delay or defraud" any present or future creditor constitutes a fraudulent transfer. *F.S. 726.* 105(1)(a). In 1988, Florida adopted the UFTA which covers the transfer of assets as well as the creation of obligations. The legislature codified the act as Florida Statute Chapter 726. Within the statute, an "asset" is defined as "property of the debtor," however, it does not include "[p]roperty to the extent it is fully encumbered by a valid lien…[p]roperty to the extent it is generally exempt under nonbankruptcy law… [and] [a]n interest in property held in tenancy by the entities to the extent it is not subject to process by a creditor holding a claim against only one tenant." F.S. 726.102(2)(a)(b)(c). Similarly, under the UFTA, a "transfer" is broadly defined as "every mode, direct, or indirect, absolute, or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset." F.S. 726.102(14).

CASE SUMMARIES

2-Bal Bay Properties, LLC v. Asset Management Holdings, LLC,

FACTS: A Florida LLC engaged in the business of purchasing and servicing residential debt went into business with John Olsen, Daniel Coosemans, and Tamiwest, LLC (collectively "2-Bal Bay") and purchased a piece of commercial real estate. 2-Bal Bay agreed to structure the transaction of the purchase of a building in Nokomis, Sarasota County. The loan taken out to purchase the property was under the name of 2-Bal Bay Properties, LLC, and the plan was for AMH to own one-half of the property. AMH never received its interest in the property despite paying half the down payment. AMH moved into the property, made several renovations in the amount of $200,548.17. After fall out between AMH and 2-Bal Bay Properties, LLC due to financial difficulties, AMH received a three day notice to pay rent or deliver possession of the premise. A suit was brought against AMH for eviction and unpaid rent, and AMH brought a counter claim for unjust enrichment and fraudulent transfer against 2-Bal Bay, Olsen, and Coosemans. During the course of litigation 2-Bal Bay Properties, LLC, quitclaimed the property to another entity owned and managed by the two of them, Tamiwest, LLC. The lower court ultimately found in favor of AMH awarding $219,500 that the tenant made toward the purchase of the property, and $200,548.17 that it put into improvements of the property. The landlord appealed and tenant cross appealed.

With respect to the fraudulent transfer claim, the Second District Court of Appeal affirmed the trial court's ruling and held that the landlord did not fraudulently transfer property because the property was encumbered with a lien and did not qualify as an asset under the Uniform Fraudulent Transfer Act at the time of the transfer. The court noted that Florida adopted the Uniform Transfer Act, and turned the definition of an "asset" within the meaning of the statute. An "asset is defined as "property of the debtor, but does not include… [p]roperty to the extent it is encumbered by a valid lien." 726.102(2)(a). The court reasoned that because the landlord's "asset" was "encumbered by a valid lien" at the time of the transfer, it did not meet the statutory definition of an "asset." For this reason, the landlord's actions were not considered a fraudulent transfer.

Rupp v. Moffo

FACTS: Angie Moffo lived in a home for eight years, rent free, in a home that belonged to her brother in law, Doug Rich. Shortly before filing for bankruptcy under Chapter 7, there was a mortgage on the property in favor of Bayrock Mortgage Company. At the time that Mr. Rich filed for bankruptcy the mortgage on the home was more than double the home's fair market value. Upon filing for bankruptcy, the Chapter 7 trustee sued Ms. Moffo for back rent pursuant to Utah's Uniform Fraudulent Transfer Act. The trustee sought $1,300 per month in bank rent, asserting that Mr. Rich had defrauded his creditors by allowing her to live in the house rent free after he became insolvent in October 2009. The district court granted summary judgement in favor of the trustee that Ms. Moffo was a recipient of a fraudulent transfer and entered a $34,200 judgment against her. Ms. Moffo appealed that ruling.

Although the Supreme Court of Utah held that the trustee had standing to bring a claim against Ms. Moffo, the court ultimately reversed the lower court's grant of summary judgement on the grounds that the debtor did not transfer an "asset" to Ms. Moffo within the meaning of Utah's Uniform Fraudulent Transfer Act. The court looked to the definition of an "asset" within the statute, noting than an "asset" is "property of a debtor, but does not include… property *to the extent it is encumbered by a valid lien.*" The court reasoned that the "home in which Ms. Moffo resided was fully encumbered by Bayrock's mortgage and any rents that may have been owed were never property of the bankruptcy estate." Instead, they "were payable to Bayrock." As a result, there was not transfer by the debtor to Ms. Moffo because the house didn't qualify as an "asset" within its statutory meaning.

Cafaro v. Zois, et al.

Facts: On February 14, 2013, Cafaro contracted with Elia Zois to rent and ultimately purchase property in Palm Beach, Florida for $10,370,000. The contract required Cafaro to make periodic payments between $330,000 to $600,000 until July 1, 2016 and monthly payments of $35,000 until December 1, 2014. On December 31, 2014, the closing date, Cafaro had to pay $8 million, and the contract also provided that Zois would lease the property to Cafaro until this day and subsequently deliver title five days before closing. With the exception of one payment, Cafaro made monthly payments between March 2013 – July 2014. Bank of America accelerated Zois's mortgage loan for transferring a leasehold interest in the property thereby securing the loan. Zois defaulted on the mortgage and Bank of America sold the mortgage to SummitBridge. Because the mortgage was defaulted on, SummitBridge initiated a foreclosure action in state court and recorded a notice of lis pendens. Additionally, because Zois failed to pay federal income taxes between 2009 – 2014, the IRS recorded a federal tax lien against the property for $3.6 million. Cafaro subsequently sued Zois, his wife and the receiver of the property during foreclosure proceedings in state court alleging breach of contract, common law fraud, and fraudulent transfer under the Florida UFTA. The district court entered summary judgement against the renter, Cafaro, and Cafaro appealed.

With respect to the fraudulent transfer claim pursuant to Florida's Uniform Transfer Act, he U.S. Court of Appeals for the 11th Circuit held that the property could not serve as an asset

under Florida's Uniform Fraudulent Transfer Act because the property transferred did not convey an "asset." In doing so, the court looked to the requirements of a fraudulent transfer under the FUFTA, a claimant must show that (1) a debtor defrauded a creditor, (2) the debtor intended the fraud, (3) the creditor conveyed an "asset" "which is applicable by law to the payment of the debt due. Here, the third prong was not satisfied considering the IRS had a valid lien on the property at the time the Zoises granted a second mortgage. Although the FUFTA defines asset as "property of a debtor," it excludes from the definition "[p]roperty to the extent it is encumbered by a valid lien," and for this reason, was not an "asset" due to the IRS lien on the property.

In re Darin

FACTS: In this case, plaintiff filed separate petitions for relief under Chapter 7, and owned and operated multiple Denny's franchise restaurants through their company known as JDJ Hospitality, LLC ("JDJ"). JDJ filed for bankruptcy, but court dismissed the case in favor of state court receivership. PNC Equipment Finance, LLC, through assignment predated the present dispute and pending cases, became JDJ's lender and beneficiary of the guarantees that Messrs. The lender contends that Messrs Darin and Lopez caused JDJ to effect transfers of PNCEF's collateral to themselves and to another entity, Banana Split Properties, LLC for their benefit with the intent to defraud PNCEF. Their theory draws on the Michigan Uniform Fraudulent transfer Act and the current version of the statute, the Michigan uniform voidable transaction act. As a result, PNC Equipment Finance, LLC, brought an adversary complaint against them.

The bankruptcy court ultimately found that the lender's claim pursuant to Michigan's Uniform Fraudulent Transfer Act was precluded for failure to specifically identify the transfers at issue, and that the existence of a valid lien on deposit accounts was not precluded based on a purported lack of control agreement. The court initially looked to the plain language of MUFTA. The court did not find it persuasive that PNCEF lacked a "valid lien" for two reasons. First, even though PNCEF is different from PNC Bank, "its statement that it did not have a "control agreement" is not supported by affidavit." Second, PNCEF "identified the transfers of concern by reference to general ledger accounts, but did not identify the deposit accounts from which JDJ allegedly made the transfer." The court further explained that PNCEF must establish that JDJ transferred *its own property,* and not the property of someone else, and that the property transferred was not subject to a "valid lien." The court explained how "PNCEF likely enjoyed automatic perfection of its security interest in the restaurant's deposit accounts under M.C.L. Sec. 440.9315(3) and (4), and after discovery it should have been able to make a *prima facie* showing, in the words of the *Steinberg* court, "that assets were available for transfer that were not encumbered by a valid lien." It failed to do that, and instead, made arguments to simply "shift the burden to defendants," the court explained.

THERMO CREDIT, LLC v. DCA SERVICES INC.

FACTS: The three relevant entities in this case are Plaintiff-appellant Thermo Credit, Defendant-Appellee DCA, and now defunct Communications Options, Inc., ("COI"). In 2010, COI, a telecommunications provider, borrowed $990,000 from Thermo Credit. In 2012, DCA considered purchasing COI, however, did not after realizing that COI had a substantial amount of debt relative to its assets. DCA decided to enter into a business relationship with COI instead of purchasing the

company and decided to take over COI's management and operations. In exchange for its services DCA would receive 40% of net profits generated by COI and monthly payments equal to 20% of the net improvement to the "Business's balance sheet during the month." In April 2012, DCA wanted to end its relationship with COI because it doubted its own ability to restructure COI successfully and did not think it would be able to make a profit from the company. However, COI and DCA entered into a new service agreement, and in part, the minimum fee paid was increased to 55,000 a month. DCA decided to take COI into Chapter 11 to "shed massive vendor debts that had accumulated over the years.

To use cash collateral to continue operating its business, COI asked bankruptcy court to afford Thermo Credit adequate protection of Thermo Credit's interest as a secured creditor by granting them a replacement lien in cash collateral generated by the post-petition operation of the debtor's business, to the extent of any valid and subsisting liens or interest held by it in cash collateral as of the petition date. On or about May 13, 2013, the judge granted an order, which granted Thermo Credit liens in all post-petition property of COI. COI discovered that the financial statements it provided to the court were inaccurate meaning that the company was in worse financial shape then realized. COI filed a motion to dismiss the bankruptcy and terminated its relationship with DCA. At this point, it had paid DCA $1,595,315.43. Thermo Credit initiated the instant case seeking to avoid and recover the monthly payments COI made to DCA. Both parties moved for summary judgement.

The district court granted SJ to DCA for two reasons: 1) None of the payments COI made to DCA after May 2013 (when COI filed for bankruptcy) qualified as fraudulent transfers under Ohio's UFTA because property is not considered an "asset" "to the extent it is encumbered by a valid lien," and Thermo Credit had a first priority lien in all of COI's cash pursuant to the bankruptcy judge's May 2013 order; thus, none of the payments made after the order qualified as "transfer of assets". However, the court did find that the pre-May 2013 payments did qualify as "transfer of assets," because it concluded that DCA "had not put forth evidence providing that Thermo Credit had a lien on COI's cash until May 20, 2013

The Sixth Circuit affirmed the lower court's ruling, finding that Thermo Credit waived its claims that the payments were fraudulent transfers because it had every opportunity to stop payments, lower them, or foreclose on the debtor's assets. The court explained how Thermo Credit was a sophisticated lender with expertise in the telecommunications field and had a great deal of access to the debtor's finances, far more access than the average consumer/competition. It made a calculated decision to approve a series of payments with another company, while benefitting from the work on the company, since the debtor was able to make its monthly payments. The court found that the bankruptcy court's order gave Thermo Credit a lien in COI's assets because otherwise, the order would have provided no real protection to Thermo Credit's interest as a secured creditor. The court explained that the post May 2013 payments were encumbered by a valid lien and are outside the purview of OUFTA because, as the court noted, the definition of an asset is one that is property of the debtor but it explicitly excludes "[p]roperty to the extent it is encumbered by a valid lien."

IN RE: FAIR FINANCE v. Textron Financial Corp., 834 F.3d 651 (6th Cir. 2016)

The facts in this case are rather consistent with the facts that follow in the 2021 case before the Sixth Circuit. Members of the fair family operated Fair Finance company (Debtor) as a profitable financial services company in Ohio. In 2002, Tim Durham and James Cochran purchased the debtor in a leveraged buyout and transformed debtor's factoring operation into a front for a Ponzi scheme, where proceeds of which went largely to fund Durham and Cochran's extravagant lifestyle and various struggling business ventures. Durham and Cochran eventually founded FHI to serve as a holding company for the debtor. In 2002, FHI entered into a loan and Security Agreement with Textron and United Bank. Textron and United gave a $22 million line of credit, and in exchange, Textron and United were entitled to interest and fees on amounts borrowed. To secure the loan FHI pledged all its assets (present and future), its non-diluted interest in the debtor. In 2003, Textron discussed the debtor and FHI's financial position and, specifically, analyzed transactions to "companies substantially owned by Tim Durham and Jim Cochran." Eventually United did not feel comfortable with the debtor's business operation and, in 2003, had written to Textron and urged it to either buy out United's interest under the 2002 Security agreement or exercise its rights under the agreement by declaring the debtor and FHI in default and accelerate the entire amount due under the promissory note. Textron chose the former and worked with the debtor and FHI to establish terms under which they would move forward without United.

Debtor and FIH entered into another security agreement and pursuant to that agreement explained the following:

1. Textron and United had "committed to make loans to [the Debtor and FIH] in an aggregate amount not to exceed $22,000,000" and that debtor and FHI "granted a security interest to [Textron and United] in substantially all [their] business assets";
2. Under the 2002 L&SA, debtor and FHI delivered to Textron "promissory notes, security agreements, mortgage deeds, guaranties and other loan documents," that, together with the 2002 L&SA, constituted the "Original Loan Documents";
3. The Debtor, FHI, and Textron "desire[d] to amend and restate the Original Agreement in order to reduce the amount of the aggregate loans to $17,500,000 and to modify certain terms and conditions of the lending";
4. "Contemporaneously with the execution of the Agreement," Textron agreed to purchase and United agreed to sell "and release all of its interest in the Original Loan Documents."

The parties also executed a new promissory note in the amount of $17,500,000.00, while Durham and Cochran executed new continuing unlimited personal guarantees. Eventually, the FBI raided Debtor's headquarters and the Ponzi Scheme collapsed, certain V-note holders filed involuntary petitions against the Debtor to enter Chapter 7. The Trustee subsequently brought aiding and abetting claims, a conspiracy claim, claims to avoid and recover actual and constructive fraudulent transfers. After the case was filed, Textron and Trustee moved to have the adversary proceedings moved to the district court.

The district court made the following rulings: The fraudulent transfer claims, as a matter of law that the 2004 Security Agreement was not a novation of the 2002 L&SA and as a result, the security interest conveyed pursuant to the 2002 L&SA continued in full force. Because Textron had valid security interests in Debtor's assets since 2002, neither the 2004 ARL&SA nor the payments made thereunder could qualify as "transfers" for the purposes of a fraudulent transfer claim. Lastly, the district court also found that any post execution bad faith on the part of Textron did not render the 2002 security interest invalid for purposes of the Trustee's fraudulent transfer claims. With respect

to the aiding and abetting claim, the court concluded that the dismissal was appropriate considering a recent Ohio Supreme Court decision in which the court explained Ohio does not recognize a "cause of action for the tortious acts undertaken." With respect to civil conspiracy, the district court found that the "allegations of the amended complaint established that the *in pari delicto* bar to tort recovery was applicable." The court explained that Durham and Cochran's conduct was imputed onto the debtor and that even if the Ohio Supreme Court would recognize an insider exception to foreclose such imputation, the Trustee did not allege that any innocent insider existed.

The Sixth Circuit made the following rulings:

1. It was improper for the district court to decide, as a matter of law on motion to dismiss, that there had been no novation and that there was no property not already encumbered by a valid lien to support trustee's actual fraudulent transfer claim. In doing so, the court explained that the Trustee established that there was an ambiguity regarding whether the parties clearly intended that the 2004 ARL&SA extinguish the 2002 L&SA and the security interest it created. The trustee sufficiently showed that the debtor's assets were no longer encumbered by a "preexisting valid lien when the parties executed the ARL&SA and the debtor granted Textron a new security in its assets. Furthermore, the Trustee stated a plausible claim for relief under Ohio' UFTA because the Trustee sufficiently showed that the 2004 ARL&SA, the security interest the Debtor granted pursuant to the 2004 ARL&SA, and all payments made by the debtor as per their obligations to that agreement amount to fraudulent transfers ***because each transaction was undertaken in an effort to perpetuate a Ponzi Scheme that inevitably collapsed and left "unsophisticated Ohio Investors holding the bag."***
2. Under Ohio law, the court explained that the Ohio Supreme Court would honor the special one-year discovery period on actual fraudulent transfer claims, finding that they begin to run when the plaintiff discovers or reasonably could have discovered, not just the transfer itself, but the transfer's fraudulent nature. In doing so, the court looked to a district court case out of Ohio (*Bradley)* whereby the court explains, that in *Bradley,* that court relied on Ohio's general discovery-rule principles to conclude that Ohio's UFTA discovery rule would only begin to run once the plaintiff had "knowledge of such facts as would lead a fair and prudent man, using ordinary care and thoughtfulness, to make further inquiry."
3. Allegations in the trustee's complaint as to purposefully inadequate disclosures and improper accounting practices employed by debtor's principal and acquiescence of lender, alleged facts which supported the inference that fraudulent nature of the obligations which debtor incurred and payments which it made to lender could not have been discovered until the FBI raided debtor's offices. The court explained that when the FBI raided Durham and Cochran's Ponzi scheme, it was revealed that there was a Ponzi scheme ensuring, a date that was delayed by Durham and Cochran's purposefully inadequate disclosures and improper accounting practices, both of which undertaken with Textron's acquiescence. Because the investors filed the bankruptcy petition a few months later, the Sixth Circuit concluded that the Trustee's "actual fraudulent transfer claim was timely" under the respective discovery rule.
4. Trustee had standing to bring civil conspiracy claim against lender. In doing so, the court reasoned that the Trustee's amended complaint against the debtor alleged an injury. Specifically, "the Trustee asserts that Textron, in exchange for hundreds of thousands of dollars in interests and fees, not only tuned a blind eye" to fraudulent behavior but assisted

Durham and Cochran in looting the debtor and transforming the business as a front for a Ponzi scheme.

5. The Trustee did not have to plead facts sufficient to negate affirmative defense of *in pari delicto* to state a conspiracy claim. The court looked at the sole actor doctrine and reasoned that "when the innocent insiders possessed authority to stop the fraud, the 'sole actor rule' does not apply" because the culpable agents who had totally abandoned the interests of the principal were acting outside the scope of their agency, and were not identical to the principal. A set of agents cannot be said to be the sole actor who are the same as the principal when others exist within the principal who had sufficient authority to stop the fraud had they known it. For this reason, the court believed that the Ohio Supreme Court would apply the innocent insider exception to the sole actor doctrine and the facts herein.
6. Under Ohio law, the doctrine of adverse domination applied to toll statute of limitations on a claim by corporation based on its officers of directors alleged fraud while corporation was dominated by misbehaving officers and directors. In doing so, the court explained how the four-year SOL was tolled because of the adverse domination doctrine until the FBI raided the debtor, and the debtor, for the first time, possessed knowledge of Durham, Cochran and Textron's alleged wrongdoing and ability to act on that knowledge. For this reason, the civil conspiracy claim was timely.

***IN RE: FAIR FINANCE v. Textron Financial Corp.*, 13 F.4th 547 (6th Cir. 2021)**

In 2002, Fair Finance entered into a $22 million revolving loan agreement with Textron Financial Corporation and another bank. The agreement created, and Textron perfected, security interest in all fair finance assets. Fair Finance raised capital for accounts receivable purchases by issuing debentures called V-notes, and using these V notes, the owners would pay off old investors and "loan" themselves and others money. The owners used the revolver money to fund "factoring activities," a front for their fraudulent scheme. At this time, new owners bought fair finance and began to run it into the ground because it used the company to perpetuate a Ponzi scheme. The following year, Textron began to express concerns internally about what it thought was going on at Fair Finance. Nonetheless, Textron and Fair finance renewed and extended the revolver with conditions designed to protect Textrons interests, whereby the remaining parties contracted for several alterations, which included decreasing the revolver limit to $17.5 million which Textron paid in full at the conclusion of the loan relationship in 2007. In 2010, Fair Finance filed for bankruptcy, the government later charged and convicted its owners of crimes connected to the Ponzi scheme. The bankruptcy trustee sought to avoid the payments, however the bankruptcy court concluded that Fair Finance's payments to Textron did not qualify as "transfers" under OUFTA because the 2002 agreement created a valid security interest that encumbered the transferred funds, survived the non-novation 2004 modifications, and was unaffected by Textron's troubling post lien-creating conduct.

The Court of Appeals for the Sixth Circuit held that pursuant to the Ohio Uniform Fraudulent Transfer Act ("OUFTA") the debtor's payment to lender under the parties' revolving loan agreement was encumbered by a "valid lien." The court first determined the "lien" was "valid," because the lender had a perfected security interest in the property irrespective of whether the lender later arguably acted in bad faith after learning about the Ponzi scheme. The court also found that any possible error in the jury instruction on novation, which stated that novation had to be shown by clear and definite evidence was harmless because under Ohio law, the point of novation

is to extinguish by new valid contract a previous valid obligation and replace it with a different one. The court explained that presuming the new revolve agreement that was executed before bankruptcy between debtor and lender, renewed rather than novated the earlier debt, then the new agreement renewed rather than extinguished the debtor's earlier debt obligation because no new "obligation [was] incurred" that could have been avoidable as a fraudulent transfer under Ohio law.

Kellstrom Bros. Painting v. The Carriage Works, Inc., et al.

Defendants Rowlett and John and Barbara Evensizer were among shareholders in defendant Carriage Works, Inc.. Before April 1988, plaintiff furnished $4,288 worth of paint and supplies to Carriage Works, which it did not been paid. **South Valley State bank (bank) had a valid perfected security interest in the assets of Carriage Works to secure loans in excess of $290,000**. Rowlett was the guarantor on one of the loans. Loans became delinquent, bank repossessed collateral worth less than the amount of the loans. Bank sold the collateral at a public sale for $83,000, the fair market value. Rowlett was one of the purchasers. Subsequently Carriage Works International was formed as a partnership, Rowlett transferred the property purchased at the sale to the partnership. Plaintiff then brought an action under the UFTA.

The Court of Appeals in Oregon ultimately agreed, and reversed in part, siding with the defendants because the definitions under the UFTA do not apply here. For a creditor to be entitled to relief under the UFTA, there must have been a "transfer" ***by the debtor.*** Here, the court explains there was no transfer by carriage works within the meaning of the act. Oregon adopted the UFTA, and the statute reads that a ""transfer" means "disposing of … an asset…" However, under the law, an "asset" is not included as debtor's property "to the extent that it is encumbered with a valid lien." The court explained how a "security interest created by agreement" fits within the meaning of a lien, and that it is undisputed that the bank held a valid security interest that encumbered all of the assets of Carriage works. It was the bank that transferred the collateral to Rowlett and another after the public sale because they were the highest bidders. For these reasons, the court found that the plaintiff was not entitled to judgment against anyone other than Carriage Works, Inc.

Preferred Funding, Inc., v. Alfred Jackson, et al.

Plaintiff, a commercial lender, sought to foreclose on assets in the possession of defendants who received the assets from a third party in allegedly fraudulent transfer. Plaintiff prevailed on all three claims, two under the UFTA, and one under the UCC.

Wayne Jarvis and Clifton Platt discussed plans to open a bar and restaurant, so Platt borrowed $120,000 from a company called "Associates," and put up around $50,000 of his own money. The two men formed Wy-Cliff Corporation as the entity to operate the business which they planned to call "Neighbors Bar & Bistro." Before opening the business Platt borrowed $270,000 at 13.9% interest from plaintiff, a "hard money" lender. Under that agreement, the borrower was Clifton Platt, a "single man" and it specified that the loan was secured by a note and trust deed executed by Platt "in his individual capacity" for Platt's personal residence, as well as "all supplies and materials to be used in connection with the rehabilitation and expansion of Mohawk Video and Neighbors Restaurant and Night Club." Platt received $94,000 of the $270,000 and the rest to

plaintiff as "loan originator fee" to pay off associates so that plaintiff could have priority on the collateral, and to miscellaneous closing costs.

Plaintiff prepared to file UCC-1 form with Corporation Division to secure the $270,000 loan, naming "Clifton E. Platt, DBA Neighbors." Neighbors didn't open well, lost money from opening day and by March it was in serious debt, and in danger of shutting down. Defendants Jackson and Harger leaned of the state of the business, so they consulted an attorney who ran a credit Check on Platt. The "UCC check" on Wy-Cliff showed no secured creditors, and then decided to loan Wy-Cliff $70,000. Harger & Jackson filed a "UCC-1" form naming Wy-Cliff as debtor and listing as collateral all Wy-Cliff's tangible and intangible assets. Because Platt was behind in payments on his $270,000 loan, an action was filed by plaintiff to foreclose on collateral – Platt's residence and tangible assets of Platt's businesses. The following events occurred during the litigation.

1. Defendants loaned additional funds to Wy-Cliff, thus, Wy-Cliff's indebtedness to defendants was $168,000, plus interest.
2. Platt and defendants suspected Jarvis of mismanagement and financial irregularities, so Platt ultimately removed Jarvis as president and director of Wy-Cliff and defendant Jackson began playing an active role in overseeing the financial affairs of Wy-Cliff.
3. Platt received notice from defendants informing him that Wy-Cliff was in default on $70,000 loan.
4. Defendants and Platt formed new corporation "Neighbors Bar & Bistro, Inc. Defendants owned 51% and Platt owned 49%, which he transferred to his parents because the Oregon Liquor Control Commission would not issue Neighbors Bar & Bistro, Inc., a hard liquor license if he was a listed owner because of his prior felony conviction.
5. Wy-Cliff executed an "Asset Transfer Agreement" (ATA) conveying all of the assets of Wy-Cliff, tangible and intangible, to defendants.

The circuit court concluded that plaintiff proved by a preponderance of the evidence that Platt was acted as an agent for Wy-Cliff in securing the loan from the plaintiff and for that reason, "Wy-Cliff is liable to plaintiff for all amounts owing." The court entered a judgement against Platt and Wy-Cliff in the amount of $310,370.24 and held that both Platt and Wy-Cliff were liable for the amount and that plaintiff was entitled to foreclose on Platt's residence and "personal property" listed in the trust need. Plaintiff filed the action against defendants under the UFTA and UCC after realizing that Wy-Cliff transferred the assets to the defendants. After adopting the findings and conclusions of the Court in *Preferred Findings, Inc. v. Platt* and making additional findings of its own, the trial court concluded that Wy-Cliff's transfer of assets to plaintiff was a fraudulent transfer as defined by the UFTA and that plaintiff could be restored to its pretransfer status by allowing it to foreclose on its security interest against the defendants.

The court held that there was no transfer of assets as that term is defined in the UFTA when Wy-Cliff transferred its assets to Harger & Jackson because the lien against those assets exceeded their value. In doing so, The Court of Appeals of Oregon looked to Oregon Law. Oregon has adopted the UFTA, and the court looked to the definition of an "asset," explaining that property is not an asset "to the extent that it is encumbered by a valid lien." In other words, only "equity in excess of the amount of the encumbering lien(s) is an 'asset' under UFTA." The property that Wy-Cliff transferred to defendants was encumbered by a valid lien in favor of defendants in the amount of

$70,000. Thus, if the value of the bar as a going concern was less than $70,000, then Wy-Cliff did not transfer any assets to defendants and no predicate exists for plaintiff's action under the UFTA.

The court explained that the evidence plaintiff presented to demonstrate that Wy-Cliff's assets exceeded $70,000 at the time of transfer was unpersuasive. Neighbors assets were valued at $22,419, and the fact that Neighbor's backers had spent nearly $500,000 on a business that within 10 months of opening could not pay its employees, landlord or suppliers, for the court, did not establish that the business had significant value as a going concern. Neighbors liabilities exceeded their assets and plaintiff did not meet its burden in showing that Neighbors had intangible assets totaling more than $50,000.00.

Lastly, plaintiff neither pleaded nor explicitly argued that Platt was Wy-Cliff's agent. Platt was careful in signing documents in his *individual capacity* rather than that of a corporate employee/on behalf of the employee. The only evidence supporting the theory that Platt acted on behalf of Wy-Cliff is the fact that the proceeds of the loan were spent on Neighbors. For that reason, there isn't sufficient evidence, nor a showing that plaintiff had an enforceable security interest against Wy-Cliff, so it has none against its transferees.

Luna Developments Group, LLC

In this case, Plaintiff Alan Barbee, the Trustee for Luna Developments Group sued Amerant Bank, to avoid and recover, as fraudulent transfers, the creation of a pledged bank account to receive and hold cross collateralized sale proceeds, and then the subsequent transfer of funds from that account to pay down the cross collateralized obligations of an affiliated entity. Luna asserted a claim against Amerant for aiding and abetting the breach of fiduciary duty of Luna's principal, Juan Arcila.

There were five counts brought in this case by the Trustee:
Count 1: Luna's grant of a security interest in the pledged account was an actual fraudulent transfer avoidable under 11 U.S.C. Sec. 544 and Florida Statutes Sec. 726.105(1)(a).
Count 2: The grant of a security interest in the pledged account was a constructive fraudulent transfer 11 U.S.C. Sec. 544 and Florida Statutes Sec. 726.105(1)(a).
Count 3: The Pledged Funds Transfer was an actual fraudulent transfer avoidable under 11 U.S.C. Sec. 544 and Florida Statutes Sec. 726.105(1)(a).
Count 4: Seeks recovery of the Pledged Funds Transfer pursuant to 11 U.S.C. Sec. 550
Count 5: The Amerant aided and abetted Mr. Arcila's alleged breach of fiduciary to Luna.

In deciding this case, Judge Grossman looked to the language of Florida's UFTA and first found that the grant of a security interest in the Pledged Account was not an avoidable transfer because Amerant already "had a lien on the $5 million in Luna Sale proceeds into the Pledged Account and the use - several weeks later – of those proceeds to pay down the BHQ loan, were not transfers subject to avoidance under FUFTA."

Next, the court found that Amerant did not release its liens before creation and funding of the pledged account. The court looked to the 2006 Mortgage Deed and Security Agreement which gave Amerant a security interest in Luna's land and buildings and property located on it, as well,

without limitation, "all present and future contracts" and all "proceeds of the conversion, voluntary or involuntary, of the Mortgaged Property, or any part thereof, into cash or liquidated claims." Similarly, the Sales Proceeds assignment which Amerant received in connection with the 2007 Cross Collateral Agreement encumbered all of Luna's "right, title, and interest in, to and under the Contracts [defined to include any sales contracts], including without limitation (a) all rights of Assignor [Luna] to receive monies due or to become due under each and any of the Contracts…" The court explained how Amerant's liens had not "yet been released at the time the Pledged Account was established and Luna granted Amerant a lien thereon."

The court found that the transactions were properly contemplated, structured, and executed under Article 9 of the UCC because Amerant's collateral was converted to "identifiable cash proceeds" on the date of closing, resulting in the continuation of perfection of Amerant's security interest in the cash proceeds under UCC Article 9-315(d)(2). The identifiable cash proceeds of $5 million that Amerant had a perfected security interest in was then deposited into the Pledged account the "same day." The court noted that Amerant also perfected by control of the collateral.

The court found that the pledged funds transfer was not an avoidable transfer because the Pledged Account "was already encumbered by a valid, perfected lien in favor of Amerant, the application of the $5 million in the account to reduce BHQ'S debt to Amerant was also not an avoidable transfer." Amerant's perfect lien on the Pledged Account was effective to secure BHQ's debt to it, and for this reason, is the $5 million transfer to Amerant was not avoidable.

With respect to the aiding and abetting breach of fiduciary duty, the court found that Luna failed to plausibly allege any breach of fiduciary duty because, as mentioned throughout the order, the lien on the Pledged Account, permitting Amerant to apply the funds in the account and to reduce BHQ's loan obligation was not an avoidable transfer, thus, not improper. The court explained how Mr. Arcila simply honored the obligation to Amerant pursuant to the Final Cross Collateral Agreement and related security documents.

Lastly, the court found that Luna failed to plausibly allege knowledge or substantial assistance because the allegations within the complaint, if proven true, would not raise a plausible inference that Amerant knew that Mr. Arcila was engaged in the breach of fiduciary duty to Luna. The 2007 Cross Collateral Agreement and Final Cross Collateral Agreement were recorded in public records, Amerant's knowledge that "Mr. Arcila requested Amerant not mention the Cross Collateral Agreement in the June 29 Letter is simply not probative of any plausible allegations that Mr. Arcila breached his fiduciary duty or that Amerant had knowledge and substantially assisted such breach of fiduciary duty."

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Faculty

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