Concurrent Session

Advanced Chapter 7 Track:

Part 1 (Tax Refunds and Returns; Legal and Equitable Issues in Property Ownership; Fraudulent-Transfer Issues; Insider Preferences; Life Insurance Exemption Issues)

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of the one who paid and a bona fide purchaser of the property for value without notice of other interests or encumbrances.

A. **MCL 555.7**

> When a grant for a valuable consideration shall be made to 1 person, and the consideration therefor shall be paid by another, no use or trust shall result in favor of the person by whom such payment shall be made; but the title shall vest in the person named as the alienee in such conveyance, subject only to the provisions of the next section.

B. **MCL 555.8**

> Every such conveyance shall be presumed fraudulent, as against the creditors of the person paying the consideration; and when a fraudulent intent is not disproved, a trust shall result in favor of such creditors, to the extent that may be necessary to satisfy their just demands.

C. **MCL 555.10**

> No implied or resulting trust shall be alleged or established to defeat the title of a purchase, for value, and without notice of such trust.

The Michigan state courts have consistently followed the will of the legislature in its jurisprudence. In **Musial v. Yatzik**, 329 Mich. 379; 45 N.W. 2d 329; 1951 LEXIS 431 Musial who was being drafted to serve in the army purchased property for his wife to live in during the time he would be gone on active duty. His wife's parents, the Yatziks, joined in the purchase agreement as purchasers of the real estate because inasmuch as Musial was going into the army, the seller did not consider Musial a good risk. Musial paid the entire $2,000.00 down payment for the house, but the parties agreed that the future payments would be made by all the parties. All parties, in fact contributed to the cost of maintaining the property and paying the land contract payments. However, the Yatziks paid more, even paying the cost of making some substantial improvements to the property. While Musial was away in the army, the Yatziks obtained title to the property and gave a purchase-money mortgage to the seller. After Musial returned and requested that the Yatziks turnover ownership of the entirety of the property to him

and his wife, the parties had a long dispute over the rightful ownership of the property. The Yatziks agreed to transfer a 50% interest to the Musials in 1947, which the Musials accepted, but two years later the Musials filed suit against the Yatzik's for the other 50%. The court refused to upset the settlement of the parties but remarked:

> "It is unfortunate that the attorneys overlooked the provisions of the Revised Statutes of 1846, ch 63 § 7 (CL 1948, § 555.7 [Stat Ann § 26.57], until we asked for briefs on the effect of the statute. Section 7 of the statute reads:
>
> "When a grant for a valuable consideration shall be made to 1 person, and the consideration therefor shall be paid by another, no use or trust shall result in favor of the person by whom such payment shall be made; but the title shall vest in the person named as the alienee in such conveyance, subject only to the provisions of the next section. (These provisions do not herein apply.)

Although the court refrains from making a ruling based on Section 555.7, it strongly implies that section would have applied had the parties not entered into a settlement.

In **Plans v. Dittrich** (In re Doncea), 72 Mich. App 202; 249 N.W. 2d 356; 1976 Mich. App. LEXIS 1083 In the *Dittrich* case, the Michigan Court of Appeals held that MCLA 555.7 does not prevent a trust from resulting in favor of one who pays consideration for property titled in the name of another where the property is titled in the name of another without the knowledge or consent of the person paying the consideration for the property. In the *Dittrich* case, the decedent purchased property with funds from a tort settlement received by her minor son and titled the property in the name of herself and her husband. Upon her death, she sought to divide up the property among all of her children according to her own wishes without regard to what she had told the son whose funds were used to purchase the property. The court further concluded that while MCLA 555.9 would allow a trust to result if favor of the one who paid the consideration for the property because the property was titled to another without his knowledge or consent, the appropriate trust according to the facts of that case was a constructive trust

because of the fiduciary relationship the mother had to the son and the mother's breach of her fiduciary duty.

Advance Drywall Company v. Wolfe-Gilchrist, Inc., 53 Mich. App. 215; 218 N.W. 2d 866; 1974 Mich. App. LEXIS 1127

In *Advance Drywall Company*, the Michigan Court of Appeals held that MCLA 555.7 and 555.8 would create an equitable interest in Plaintiff Creditor of Wolfe-Gilchrist, Inc. in 90 acres of land paid for by Wolfe-Gilchrist, Inc. but titled in the names of the individuals, Wolfe and Gilchrist. The titling of the land in the names of the individuals when the corporation paid for the land is presumptively fraudulent with respect to the corporation's creditors according to those statutes, unless the individuals met their burden of proof that they paid valuable consideration for the land and therefore, the transfers were not fraudulent. Neither Wolfe nor Gilchrist could shoulder that burden. Thus, the court found in favor of the Plaintiff.

The lesson of the foregoing statutes and cases is that counsel in Michigan should be careful to ask the additional question of his client: not simply "do you own any real estate?", but "has anyone added you to the deed to his property?", "has anyone added you to his bank account"?, "has anyone added you to the title of his motor vehicle? Trustees are certainly asking those questions. Arguably, MCLA 555.7 applies to the grant of any kind of real or personal property in Michigan. The statute and the cases are silent when comes to type of property. Who is to say that when a father signs a note for a vehicle that his son drives and makes the payments for that the vehicle in a dispute between the father and the son, the father is not entitled to the vehicle. Section 555.7 and the cases interpreting it suggest very strongly that no one can in Michigan Moreover, some of the cases deal with circumstances in which there was significant time between the acquisition of the property and the subsequent titling of the property in the

name of another. Therefore, the transfer of property from a parent to a child during the parent's lifetime for probate purposes would also fall within the purview of the statute.

In states other than Michigan, courts generally use the concepts of resulting and constructive trusts as well as that of bare legal title to find that the debtor and therefore, the trustee has no equitable interest in property titled to the debtor for little or no consideration.

In **Swinson v. Fritz (In re Lytle)**, 2010 Bankr. LEXIS 4337 an Oklahoma bankruptcy court held that where a vacant lot was purchased by Fritz with his own funds and funds he borrowed from his parents and for which Fritz paid all the costs of maintaining the property and the loan payments to his parents, even though the deed to the lot was put in the name of Fritz and his business partner Lytle who together planned to develop the property, when Lytle transferred his interest in the lot to Fritz within 90 days of he and his wife filing bankruptcy, the court determined that under Oklahoma law a resulting trust was created, Lytle held only bare legal title, and Lytle was obligated to transfer title to Fritz upon demand.

> "[when a transfer of real property is made to one person, and the consideration therefor is paid by or for another, a trust is presumed to result in favor of the person by or for whom such payment is made." This type of trust is commonly referred to as a resulting trust."

The court goes on to find that a transfer of bare legal title does not constitute a transfer for purposes of either §547 or §548. Note that the Oklahoma statute yields the exact opposite result from the Michigan statute.

In **Tolz v. Miller (In re Todd)**, 2008 Bankr. LEXIS 3171; 21 Fla. L. Weekly Fed. B 726 a Florida bankruptcy court held that transfer of bare legal title to real estate to the debtor and the debtor's subsequent transfer of that real estate for no consideration was not a fraudulent transfer recoverable for the benefit of the estate. The court held that inasmuch as the debtor maintained

bare legal title of the real estate in trust for the original transferee at the time of the transfer, the debtor essentially received reasonably equivalent value for the transfer. The Florida court likewise used Florida resulting trust law as a basis for its decision.

JUDGMENTS OF DIVORCE AND FRAUDULENT TRANSFERS

Steinberg Shapiro & Clark

I. Introduction

In the past, courts have been loath to set aside property settlements made in connection with divorce proceedings. This aversion to attacks on property settlements has slowly taken a change of course. In 1999, the Sixth Circuit in *In re Fordu*, held that property divisions incident to divorce may be avoided by a trustee in bankruptcy if the elements of a fraudulent transfer are present[1]. More recently, the Supreme Court of Michigan, in *Estes v. Titus*, held that a property settlement entered in connection with a divorce proceeding is subject to attack by a creditor under Michigan's fraudulent transfer statutes.[2]

II. Fraudulent Transfer Law

In bankruptcy, fraudulent transfers are governed by 11 U.S.C. §§ 544(b) and 548. At the state level, Michigan's fraudulent transfer law is codified at Mich. Comp. Laws § 566.31 *et seq.*—Michigan's version of the Uniform Fraudulent Transfer Act ("MFTA"). Although there are differences, the laws are generally applied in the same manner. Fraudulent conveyance laws allow a creditor (or a trustee in bankruptcy) to set aside transfers of a debtor's property that reduced the property available for satisfaction of the debtor's debts.

Bankruptcy trustees are empowered by the U.S. Bankruptcy Code[3] (the "Code") to avoid

[1] *Corzin v. Fordu (In re Fordu)*, 201 F.3d 693 (6th Cir. 1999).

[2] *Estes v. Titus*, 481 Mich. 573 (2008).

[3] 11 U.S.C. § 544(b) permits a trustee to avoid transfers in accordance with state law. Therefore, if a creditor could avoid such a transfer under the state fraudulent transfer act, the trustee can

fraudulent transfers through application of both state and federal fraudulent conveyance law. Under both the MFTA and the Code, there are two avenues that a creditor or trustee may pursue when seeking to avoid a fraudulent transfer: actual fraud and constructive fraud.

Actual Fraud. Actual fraud refers to transfers of property or obligations incurred by a debtor "with actual intent to hinder, delay, or defraud."[4] Where a debtor has transferred assets to another party with the specific intent of keeping those assets from the reach of creditors, the law allows creditors to "avoid" the transfer and recover the assets. Given the subjective nature of actual intent, it is difficult to prove by direct evidence; thus, courts generally rely on the traditional "badges of fraud" to establish fraudulent intent.[5] Michigan's statute on fraudulent transfers made with actual intent to defraud contains several examples of badges of fraud, including: the transfer was made to an insider, the debtor retained control of the transferred property, the transfer was concealed, the consideration for the transfer was inadequate, and the debtor was insolvent at the time of the transfer.[6]

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avoid such transfer in a bankruptcy setting. *Id*.

[4]11 U.S.C. § 548(a)(1)(A); M.C.L. § 566.34(1)(a).

[5]*See United States v. Leggett,* 292 F.2d 423, 426 (6th Cir. Mich. 1961)

[6]M.C.L. § 566.34(2).

Constructive Fraud. Constructive fraud refers to certain transfers made for less than reasonably equivalent value.[7] For constructive fraud, the creditor or trustee merely has to prove that the transfer was made (1) for less than reasonably equivalent value and (2) the debtor was insolvent or became insolvent as a result of the transfer. In other words, intent is not an issue. If the debtor's debts exceed his assets, *it does not matter if the transfer was made without any deceptive intent at all*, what matters is whether reasonably equivalent value was received in exchange.

The idea is that if a transfer was made for reasonably equivalent value, the debtor occupies roughly the same position as he did prior to the transfer.[8] But if the debtor made the transfer for inadequate consideration, the debtor is worse off financially, rendering his debt less collectible, after the transfer is completed.[9] A "transfer" is defined as each "mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with" property or an interest in property.[10] An important difference between the fraudulent transfer provisions of the Code and those of the MFTA is that under the Code, the trustee can only avoid a transfer made within two years of the bankruptcy filing; but under Michigan's statutes, the look-back is six years after the transfer occurs.[11]

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[7]11 U.S.C § 548(a)(1)(B); M.C.L. § 566.35(1).

[8]Amanda Barkey, Note: *The Application of Constructive Fraud to Divorce Property Settlements: What's Fraud Got to Do With It?*, 52 Wayne L. Rev. 221, 226 (2006) (citing ACLI Gov't Sec., Inc. v. Rhoades, 653 F. Supp. 1388, 1390 (S.D.N.Y. 1987).

[9]*Id.*

[10]11 U.S.C. § 101(54); M.C.L. § 566.31(l).

[11]M.C.L. §§ 566.31; 600.5813.

Insolvency. An individual is insolvent when the amount of their debt exceeds the value of their property, at a fair valuation.[12]

Reasonably Equivalent Value. Neither the Code or the MFTA define the phrase "reasonably equivalent value." The Code does define "value," for fraudulent transfer purposes, as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but [it] does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor."[13] The MFTA defines value in virtually identical terms.[14] Thus, the term "reasonably equivalent value" has been deemed to have the same meaning under the MFTA as it does under the Code.[15]

The purpose of the reasonably equivalent value requirement "is to conserve the debtor's estate for the benefit of creditors."[16] The question of whether the debtor received reasonably equivalent value is a fact issue that requires a comparison between the value of what the debtor received to the value of what the debtor transferred.[17] Often, cases look for an "economic

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[12]11 U.S.C. § 101(32)(A); M.C.L. § 566.32(1).

[13]11 U.S.C. § 548(d)(2)(A).

[14]M.C.L. § 566.33(1), stating in part:

> Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied. Value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person.

[15]*See Gold v. Marquette University,* 2011 Bankr. LEXIS 1172, *28 (Bankr. E.D. Mich. 2011) (citations omitted).

[16]*Alix v. Beim (In re Fred Sanders, Inc.)*, 1997 U.S. Dist. LEXIS 19382 (E.D. Mich. Oct. 27, 1997) (citation omitted).

[17]*In re Fordu*, 201 F.3d at 707.

benefit" in deciding whether the exchange of value was reasonably equivalent.[18]

III. Application of Fraudulent Transfer Law to Property Settlements in Divorce

In Michigan, property is divided among divorcing parties based on "fair and equitable" standards.[19] That is a significantly different standard than what is applied in determining whether a fraudulent transfer occurs under either the Code or the MFTA.

Over the years, different courts have treated fraudulent transfer claims incident to divorce in a number of ways. Historically, courts have been reluctant to avoid property settlements through constructive fraud partially due to the tension between state and federal law, along with bankruptcy courts' preference to stay out of family matters.[20]

In her Note "The Application of Constructive Fraud to Divorce Property Settlement: What's Fraud Got to do with it?", Amanda Barkey summarizes:

> Some courts have placed property settlements incident to divorce beyond the reach of fraudulent transfer laws, whether or not the settlement was actually or constructively fraudulent. Other courts have allowed the defense of issue preclusion in constructive fraud claims to preclude avoidance. Still other courts use a "surface determination" test in constructive fraud claims in order to determine whether the transfer was made for reasonably equivalent value, thus

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[18] *Allard v. Flamingo Hilton (In re Chomakos)*, 170 B.R. 585, 590 (Bankr. E.D. Mich. 1993), *aff'd* 69 F.3d 769 (6th Cir. 1995).

[19] M.C.L. § 552.401.

[20] Amanda Barkey, *The Application of Constructive Fraud to Divorce Property Settlements: What's Fraud Got to Do With It?*, 52 Wayne L. Rev. at 227 (citing *In re Falk*, 98 B.R. 472 (D. Minn 1989); *In re Sorlucco*, 68 B.R. 748, 653 (Bankr. D.N.H. 1986).

avoiding looking too carefully at the decree entered by the state court.[21] (citations omitted)

In 1999, in *Fordu*, the Sixth Circuit rejected both the issue-preclusion defense[22] and the "surface determination" test, and concluded that "the standards for measuring the fairness of a property division in the domestic relations arena and reasonably equivalent value in a fraudulent transfer case are separate and distinct."[23] The case was remanded to the bankruptcy court for further proceedings on the Trustee's fraudulent transfer claims.[24] Although *Fordu* dealt with Ohio fraudulent transfer statutes, two of the four statutes at issue were identical to Michigan's fraudulent transfer statutes.[25] So, *Fordu* made it clear that property transfers in divorce must be examined for reasonably equivalent value under a challenge by a bankruptcy trustee.

Any remaining question of whether the MFTA applies to transfers made pursuant to a settlement agreement in a divorce proceeding was put to rest by the Supreme Court of Michigan, in *Estes v. Titus*, 481 Mich. 573 (2008). In *Estes,* a creditor of Jeff Titus sought to set aside transfers made by Titus to his ex-wife under a property settlement incorporated into their judgment of divorce.[26] In a unanimous opinion, the Court held that the MFTA applies to such transfers unless the property was owned by the husband and wife as tenants by the entirety

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[21] *Id.*(citing cases)

[22] The 6th Circuit rejected the issue preclusion defense on the basis that (1) the fairness of the property division was not actually litigated in the divorce proceeding and the Trustee's fraudulent transfer claims could not have been litigated in the divorce proceeding. *Corzin v. Fordu* (*In re Fordu*), 201 F.3d 693, 704-10 (6th Cir. 1999).

[23] *Id.* at 707.

[24] *Id.* at 711.

[25] Compare O.R.C. §§ 1336.04(A) and 1336.05 to M.C.L. §§ 566.34 and 566.35.

[26] *Estes v. Titus*, 481 Mich. at 578.

("TBE").[27] The MFTA makes an exception for property held as TBE when the creditor seeking to avoid the transfer is a creditor of only one of the spouses.[28] In that situation, there is not an avoidable transfer of property under the MFTA. So, if a creditor or bankruptcy trustee is seeking to avoid a transfer under the MFTA, it is important to determine if the property was owned as TBE and if the debt is joint or the sole debt of only one of the spouses. But, if a bankruptcy trustee is seeking to avoid the transfer under the two year look-back provided under the Code, the TBE exception does not apply.[29]

Estes dealt with allegations of actual fraud; however, based on the Court's "plain-language" analysis, it is axiomatic that the constructive fraud provisions of the MFTA would also apply to a divorce-related settlement agreement.[30] The *Estes* case was remanded for a determination on whether Titus made the transfers with actual intent to defraud such that the transfers were avoidable under the MFTA.[31]

IV. Conclusion

If a potential client requests that you file a bankruptcy for them and a divorce is looming, it is generally a better tact to file the bankruptcy before the divorce. If your client insists on proceeding with the divorce first or there are other reasons why the divorce should proceed before the bankruptcy, make sure the family law attorney is aware of the fraudulent transfer laws. Insist that the family law attorney prepare a spreadsheet that reflects what is being

[27] *Id.* at 592.

[28] *Id.* at 580-82; M.C.L § 566.31(b)(iii).

[29] *Lasich v. Wickstrom* (*In re Wickstrom*), 113 B.R. 339, 350 (Bankr. W.D. Mich. 1990)

[30] *Estes v. Titus*, 481 Mich. at 579-80.

[31] *Id.* at 593

exchanged and the estimated value of those items. They should try to tie transfers together, so that the client is giving something of reasonably equivalent value for what is being received. Appraisals, informal or formal, will always be helpful if a transfer is challenged. Finally, if the divorce has occurred before you are consulted about a bankruptcy, be sure to review the divorce papers and inform your client of what could happen if a creditor or trustee in bankruptcy challenges any of the transfers.

FRAUDULENT CONVEYANCES
TRANSFERS BETWEEN OR ON BEHALF OF FAMILY MEMBERS
Kelly M. Hagan

Ackerman v. Alesius (In re Alesius), Adv. Pro. No. 08-08099-478 (Bankr. E.D.N.Y. November 1, 2010)

Debtor's non-filing wife owned residential real property in which she and Debtor resided. Both contributed to the payment of the mortgage and household living expenses, but acknowledged there were times when the non-filing spouse's income was insufficient to cover those expenses, and the debtor then paid those. Additionally, Debtor transferred a boat to his non-filing spouse, claiming it was a gift and that it was done because earlier in their relationship the wife had contributed funds to cover the costs of several of Debtor's expenses. The ongoing maintenance and ownership costs were paid from their pooled income; when the boat was sold, the sale proceeds were deposited into the non-filing spouse's account. The Trustee commenced an adversary proceeding seeking, among other things, a judgment that the debtor's transfer of monies and other property to pay for the mortgage, utilities, and maintenance of the residential real property and the boat were actual or constructive fraudulent conveyances. As to the mortgage payments, the court determined that the debtor received reasonably equivalent value, as "he was afforded a place to stay, to have his meals, and to take care of other normal and usual living expenses." *Id.* at *4. Accordingly, the court found in favor of the defendants on that claim.

As to the boat, however, the court found differently. The court noted that the transfer of ownership to the debtor's wife did nothing to change the circumstances of payment of the expenses (which were paid from their pooled funds both before and after the transfer of the boat to the wife), and that the debtor continued to utilize the boat as he had while the boat was titled in his name; the transfer simply served to remove the boat from the grasp of the debtor's creditors. Accordingly, the court found that the transfer to the debtor's wife had sufficient badges of fraud to be found a fraudulent conveyance. Concluding that the debtor's funds had ultimately been used to pay for the costs of the boat (since the non-filing spouse's income was insufficient to pay for both the mortgage and the boat and apparently disregarding for purposes of the boat the fact the debtor and his wife pooled their money), the court determined that the Trustee was entitled to a judgment for the amount of the expenses paid to maintain the boat for the period after the transfer to the non-filing spouse until its sale.

Banner v. Linsday (In re Lindsay), Adv. Pro. No. 08-9091 (May 4, 2010)
Shortly after the debtor's business partner commenced an action against him, the debtor engaged in various transfers, including the payment of his son's college tuition. The Chapter 7 Trustee filed an adversary proceeding against the debtor and his wife, *inter alia*, seeking recovery of the property transferred, including the monies paid to the college. Noting that the debtor presented no evidence of a legal obligation to pay his son's tuition, the court rejected the defendants' claim that they were morally obligated to pay for their child's college education, a claim for which

they offered no authority. The court held that the defendants' payment of their son's college tuition was an avoidable transfer under New York State Law and ordered the defendants to pay that amount to the Trustee, for the benefit of the estate.

See also Gold v. Marquette University (In re Leonard), Adv. Pro. No. 10-4608 (Bankr. E.D. Mich. April 8, 2011) (rejecting the debtors' argument that they received reasonably equivalent value in exchange for the payment of their son's college tuition, where debtors claimed they received "peace of mind" from the opportunities that would be bestowed their son and the expectation that they would not remain financially responsible for him; rather, actual economic benefit was received by debtor's son).

Hagan v. Goldstein (In re Goldstein), Adv. Pro. No. 09-80264 (May 14, 2010)
Chapter 7 Trustee filed fraudulent conveyance proceeding against debtor's non-filing spouse, alleging that the debtor's transfer of monies to his spouse's bank account, for the purpose of paying household bills, was avoidable. Trustee filed a motion for summary judgment under Rule 56 on the theory that the transfers were constructively fraudulent. *See* 11 U.S.C. § 548(a); *see also* M.C.L. § 566.31 *et seq*. The parties agreed on the elements of avoidance, but the defendant asserted that she had provided reasonably equivalent value in exchange for the transfers. The defendant contended that she was essentially a housewife who did not make a meaningful financial contribution to the estate (in part owing to mental and substance abuse problems), but that the damages should be mitigated to the extent she gave reasonably equivalent value indirectly to the debtor. *See Rubin v. Manufacturers Hanover Trust Company*, 661 F.2d 979, 991-92 (2d Cir. 1981) ("If the consideration given to the third person has ultimately landed in the debtor's hands, or if the giving of the consideration to the third person otherwise confers an economic benefit upon the debtor, then the debtor's net worth has been preserved . . ."). Defendant having failed to provide concrete evidence in support of her indirect benefit theory, the bankruptcy court ruled in favor of Trustee-Plaintiff.

Zubrod v. Kelsey (In re Kelsey), 270 B.R. 776 (10th Cir. BAP 2001)
The debtor and his non-filing spouse maintained a joint check account into which the debtor deposited his paycheck and from which both he and his wife, a homemaker, wrote checks to pay for family living expenses. Prior to the bankruptcy, and after an arbitration order and judgment was entered against him, the debtor withdrew all of the funds, paid some bills, and then gave one-half of the cash he had withdrawn to his wife. After the debtor filed bankruptcy, his wife deposited those funds back into the joint account. The Chapter 7 Trustee initiated an adversary proceeding against the debtor and his spouse to avoid the transfer by the debtor to his wife. Debtor's wife argued that the funds she received represented her one-half of the account monies, and also argued that if the debtor had transferred his funds, that he had received reasonably equivalent value for the transfer. After trial, the bankruptcy court entered judgment in favor of the Trustee, easily finding that the withdrawn funds were the debtor's property and that the debtor had not received reasonably equivalent value.

On appeal, the BAP discussed the wife's argument "that her agreement to forego employment outside the home, to take care of the family, and to provide comfort, advice, and society as [the debtor's] wife constitute value." *Id*. at 781. Determining that a spouse's love and support does not constitute reasonably equivalent value, the Panel upheld the bankruptcy court's decision.

Similarly, the Panel concluded that the record also supported the Trustee's claim of actual fraud.

Kaler v. Craig (In re Craig), 144 F.3d 587 (8th Cir 1998)
During the 9 month period leading up to the bankruptcy, the debtor deposited his income into a NOW account in his wife's name, while his wife deposited her income into a separate savings account also in her name. The funds in the NOW account were used to pay household and other living expenses, leaving wife's income and interest untouched. The Trustee filed an adversary proceeding under 11 U.S.C. § 548 seeking to recover the funds in the account holding funds attributable to wife's income and proceeds from sales of her property. The Trustee did not contend that the debtor fraudulently transferred his assets directly to his wife's savings account, but that the debtor indirectly transferred his assets to his wife by using his income to pay more than his fair share of the family's expenses, thereby allowing his wife to accumulate wealth in her savings account. The bankruptcy court disagreed.

The Eighth Circuit affirmed the district court, finding that the Trustee did not meet his burden of proof in showing lack of reasonably equivalent value, citing a state statute that imposes a duty upon a husband and wife to support one another through both their individual property and labor. N.D. Cent. Code § 14-07-03 (1997). Evidence showed that debtor/husband contributed the bulk of the financial support for the family while his wife assumed most of the family's household duties, including all cleaning, laundry, and yard work.

However, as to another of the Trustee's claims, the Court of Appeals determined that the bankruptcy court defined the term "transfer" too narrowly. The debtor had been the recipient of loan proceeds, which he opted to received mostly in the form of a payment towards the seller of property that was placed in his wife's name and the remainder of which was placed in a joint bank account. The Eighth Circuit determined this was in fact a fraudulent transfer. The Court also commented on the fact that, even though the debtor never physically possessed the loan proceeds before they were transferred, the Uniform Fraudulent Transfer Act simply requires that the debtor has acquired rights in the asset transferred.

Reitmeyer v. Meinen (In re Meinen), 232 B.R. 827 (Bankr. W.D.Pa. 1999)
In this case, the Trustee asserted various fraudulent conveyance claims against debtor and his wife, including a count that funds deposited by the debtor into an account owned with his wife was a fraudulent transfer. (Note that in Pennsylvania, there is a presumption that married couples own joint bank accounts as tenants by the entirety.) The defendants argued that the debtor's deposits into the joint account were not fraudulent because each deposit was used to fund payment of the debtor's reasonable and necessary household expenses. The court agreed, but clarified that defendants would not be able to shield from avoidance those deposits which were used by defendants to purchase other assets held as tenants by the entirety. Because the defendants bore the burden of proof with respect to whether the deposits were used to satisfy debtor's reasonable and necessary household expenses, and the court had insufficient facts on these issues, the Trustee's motion for summary judgment was denied without prejudice.

Dietz v. St. Edward's Catholic Church (In re Bargfrede), 117 F.3d 1078 (8th Cir. 1997)
Prior to this couple's bankruptcy, the debtor wife had pleaded guilty to embezzlement from a church, which was awarded a civil judgment against wife. The couple had made three different

payments to the church, the first of which was from the sale of their homestead, the second of which was from the sale of their personalty, and the third of which was made by the husband, from his pension and profit sharing accounts. Less than one year after this last payment, the couple filed for Chapter 7 bankruptcy. The Trustee filed an adversary proceeding alleging that the payment from the husband's account was a fraudulent conveyance, or in the alternative, a preferential payment. He also sought recovery of the husband's interest in the sale proceeds of the homestead and personalty as fraudulent under Iowa law. The bankruptcy court granted the church-defendant summary judgment as to all three transfers, "finding the release of a possible burden on the marital relationship and the preservation of the family relationship constituted reasonably equivalent value and consideration to [the husband]." *Id.* at 1079.

The Court of Appeals determined that the bankruptcy court erred in holding that the husband received reasonably equivalent value for the transfer of his pension funds, finding the transfer directly benefitted the wife, not the husband. "To the extent Stanley received indirect, non-economic benefits in the form of a release of a possible burden on the marital relationship and the preservation of the family relationship, we find these sufficiently analogous to other intangible, psychological benefits to conclude that they do not constitute reasonably equivalent value. *See In re Young*, 152 B.R. 939, 948 (D.Minn.1993) (moral obligations not reasonably equivalent value), *rev'd on other grounds*, 82 F.3d 1407 (8th Cir.1996); *see also In re Treadwell*, 699 F.2d 1050, 1051 (11th Cir.1983) (love and affection not reasonably equivalent value); *Zahra Spiritual Trust v. United States*, 910 F.2d 240, 249 (5th Cir.1990) (spiritual fulfillment not reasonably equivalent value)." *Id.* at 1080. The Court of Appeals also predicted that the Iowa Supreme Court would find likewise as to the state law fraudulent conveyance claims. The case was remanded for the consideration of other issues not previously addressed by the bankruptcy court.

Taunt v. Hurtado (In re Taunt), 342 F.3d 528 (6th Cir 2003)
Debtors incurred significant debts around the same time at which they received two large blocks of income. Rather than paying their creditors or depositing funds into their accounts, the debtors transferred the money to husband's mother, the defendant. Defendant deposited the money into a bank account over which she and Defendant's husband had exclusive control. However, she only spent the funds in that account at the direction of the debtors, and never spent any of it for herself. The debtors used these funds to pay living expenses and certain of their creditors. The defendant held the funds for over three years, and received no consideration for her aid. The Chapter 7 Trustee filed a complaint to avoid and recover the transfers and to revoke the debtors' discharge. The debtors were later dismissed from the action by the bankruptcy court, which decision was not appealed.

As to the claims against the defendant-mother, the bankruptcy court granted her motion for summary judgment on the grounds that she was not liable under 11 U.S.C. § 550, reasoning she never had sufficient control over the money for liability to attach; rather, she was a mere conduit of the funds. The district court reversed, determining she was liable as an initial transferee under 11 U.S.C. § 550. After remand and another appeal, the defendant appealed to the Court of Appeals the sole question of whether she was liable under 11 U.S.C. § 550. On appeal, the Sixth Circuit found that she had the requisite dominion and control over the disputed funds to make her an initial transferee subject to liability under 11 U.S.C. § 550.

FRAUDULENT CONVEYANCES
CAN A DEBTOR "UNDO" A CONVEYANCE?

Kelly M. Hagan

Moyer v. Nino (In re Nino), No. 1:08-CV-721 (W.D. Mich. February 18, 2009)
When the debtor and his wife first purchased their residence, they held it as tenants by the entireties. Subsequent to the debtor husband suffering a serious heart attack (and incurring large medical bills), the debtor and his wife transfer their interest in the home to the wife alone. Approximately a year later, and on the advice of bankruptcy counsel, Debtor's wife conveyed the property back to Debtor and her as entireties property. The husband filed bankruptcy, claiming Michigan exemptions. The Chapter 7 Trustee filed an adversary proceeding against Debtor's wife seeking to avoid the transfer to wife alone as a fraudulent transfer. The bankruptcy court dismissed the action, for the reason that no meaningful relief could be granted, since the property was now property of the estate.

The Trustee also filed an objection to the claimed exemption. On that issue, the bankruptcy court determined that the transfer was fraudulent, as the debtor's interest property should have been available to the debtor's creditors after the property ceased being entireties property, and the exemption was therefore denied. On appeal, the district court recognized longstanding Michigan precedent holding that creditors cannot complain of the disposition of exempt property, essentially the "no harm, no foul" rule. Additionally, there was no indication the debtor attempted to conceal the transfer, and in light of the policy in Michigan favoring the protection of a homestead from the claims of creditors, the district court reversed the bankruptcy court's denial of the debtor's claimed exemption.

First Beverly Bank v. Adeeb (In re Adeeb), 787 F.2d 1339(9th Cir. 1986)
Faced with the threat of collection efforts, the debtor consulted an attorney with little or no bankruptcy experience. This attorney advised the debtor "to transfer title to some of his real property for no consideration to third parties who could be trusted." *Id.* at 1341. In reliance on the attorney's advice, the debtor did just that. As his financial situation worsened, the debtor sought advice from a bankruptcy attorney, who advised him to reverse the transfers and to disclose them to his creditors. The debtor began the process of reversing these transfers, and called a meeting of his creditors, at which he informed them about the transfers and his then-current efforts to reverse them. Shortly thereafter, three of his creditors filed an involuntary petition against him, which petition he opted not to contest; within days he filed his own voluntary petition. The debtor was unable to recover all of the transferred property before the petition was filed.

Plaintiff, one of the debtor's creditors, filed a complaint against the debtor under 11 U.S.C. § 727(a)(2)(A) and in the alternative, § 523. The bankruptcy court consolidated the two actions, and found that the debtor's discharge was barred by § 727(a)(2)(A), thereby rendering the § 523 claims moot. The debtor appealed to the district court, which denied his appeal, and then to the Ninth Circuit. He raised three bases in support of his request for reversal, including the assertion

that a debtor who voluntarily reverses transfers penalized by section 727(a)(2)(A) should not be denied a discharge. In essence, he argued that the property had to remain transferred at the time of the petition to support a denial of discharge under the referenced section.

In reviewing the debtor's argument, the court looked to the definition of "transfer," as found in 11 U.S.C. § 101(48), but found that neither the definition nor the legislative history shed much light on the proper interpretation of "transferred" in that context. The Court of Appeals concluded that "reading 'transferred' as used in section 727(a)(2)(A) to mean 'transferred and remained transferred' is most consistent with the legislative purpose of the section. The language of section 727(a)(2)(A) demonstrates that Congress intended to deny discharge to debtors who take actions designed to keep their assets from their creditors either by hiding the assets until after they obtain their discharge in bankruptcy or by destroying them." *Id.* at 1344 (citations omitted). In support of its conclusion, the Court noted that such a reading encourages honest debtors to recover transferred property and permits the honest debtor to undo his mistake. Although the debtor had not recovered all of the transferred property prior the petition, the Court noted that he revealed the transfers and made a good faith effort to recover the property prior to the involuntary petition. In dicta, the Court suggested that a voluntary filer would be required to show that he or she had recovered substantially all of the transferred property prior to filing. The case was remanded for further proceedings.

Cf. Davis v. Davis (In re Davis), 911 F.2d 560 (11th Cir. 1990) (rejecting interpretation that "transferred" means "transferred and remained transferred" and denying the debtor's discharge where transferred property was recovered by the debtor pre-petition).

Cf. In re Bajgar, 104 F.3d 495 (1st Cir. 1997) (re-transfer "subsequent to filing a voluntary bankruptcy petition does not cure the fraudulent transfer, and thus, does not avail the debtor discharge under Section 727").

Cf. Village of San Jose v. McWilliams, 284 F.3d 785, 794 (7th Cir. 2002) (holding that "attempts, successful or not, to conceal, transfer, remove or destroy property cannot be later cured by remedial conduct, including undoing any transfers, if the transfer occurred within one year of filing the bankruptcy petition" and remanding to the bankruptcy court for further proceedings not inconsistent with that holding).

Fraudulent Conveyances
Pleading Issues and the Impact of *Stern v. Marshall*

Steinberg Shapiro & Clark

I. Pleading Standards

A. Pleading Standards Under the Federal Rules of Civil Procedure

- Pleading in federal cases is governed by Rules 8 and 9 of the Federal Rules of Civil Procedure.
- Rule 8 provides for a general pleading standard: "a short and plain statement ... showing that the pleader is entitled to relief."
- Rule 9 provides for a heightened pleading standard for specified matters, most notably fraud ("In alleging fraud ... a party must state with particularity the circumstances constituting fraud").

B. Pleading Fraud With Particularity

- Where fraud is alleged, the concept of notice pleading is refined by a requirement of specificity.
- To satisfy Federal Rule of Civil Procedure 9(b), "a plaintiff must at a minium allege the time, place and contents of the misrepresentations upon which he relied." *Bender v. Southland Corporation*, 749 F.2d 1205, 1216 (6th Cir. 1984).
- The purpose behind the particularity requirement of Rule 9(b) is to "protect the defending party's reputation, to discourage meritless accusations, and to provide detailed notice of fraud claims to defending parties." *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir.1994).
- In cases where the plaintiff is not a third party trustee but an actual participant in the transaction and theoretically has direct knowledge of the factual underpinnings of claimed fraud, bankruptcy courts have consistently required compliance with the standards of Fed.R.Civ.P. 9(b). *In re Schwartzman,* 63 B.R. 348, 355 (Bankr. S.D. Ohio 1986).
- While some courts relax the particularity requirements of Rule 9(b) somewhat for fraud claims brought by trustees due to lack of personal knowledge of the underlying events, others do not. *See Silverman v. H.I.L. Assoc, (In re Allou Distributors, Inc.)*, 387 B.R. 365, 385 (Bankr. E.D.N.Y. 2008) (applying relaxed standard); *contra Airport Blvd. Apts. Ltd. v. NE 40 Partners, L.P. (In re NE 40*

Partners, L.P.), 440 B.R. 124, 128 (Bankr. S.D. Tex. 2010) (declining to apply a relaxed standard to plaintiff trustees because the Fifth Circuit reads Rule 9(b) strictly and a Chapter 7 trustee has "many tools in his tool belt" to assist in gathering the requisite knowledge to plead fraud with particularity) Even in deciding cases applying a more relaxed standard for a trustee plaintiff, courts generally insist on more than broad assertions, mere conclusions, and repetition of statute. *In re Schwartzman* at 355 (citing cases).

C. Pleading Standards After *Twombly & Iqbal*

Federal Rule of Civil Procedure 12(b)(6) provides that a party may assert by motion its defense of failure to state a claim upon which relief can be granted.

- To survive a motion to dismiss, a complaint must contain sufficient facts, which if accepted as true, "state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007).

- A plaintiff has to provide the "grounds of his 'entitlement to relief' rather than labels, conclusions or a formulaic recitation of the elements of a cause of action." *Id*. at 555.

- Bald assertions and conclusions of law do not suffice to defeat a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6). *Amron v. Morgan Stanley Inv. Advisors Inc*., 464 F.3d 338, 344 (2d Cir. 2006).

- A pleader must "amplify a claim with some factual allegations in those contexts where such amplification is needed to render the claim plausible." *Ashcroft v. Iqbal*, 129 S.Ct. 1937,1944, 173 L. Ed. 2d 868 (2009).

- Heightened pleading standards apply to Trustees in bankruptcy. *See In re Caremerica, Inc.* 409 B.R. 737 (Bankr.E.D. N.C. 2009); *Airport Blvd. Apts. Ltd. v. NE 40 Partners, L.P. (In re NE 40 Partners, L.P.)*, 440 B.R. 124, 128 (Bankr. S.D. Tex. 2010)

- Pleading actual fraudulent transfers: See Rule 9(b) referenced above (heightened pleading standard).

- Pleading constructively fraudulent transfers: (allegations regarding receipt of less than reasonably equivalent value and insolvency): In addition to dates, amounts, and names of transferees, complaint should identify the consideration received by each transfer, state information indicating why the value of such consideration was less than the amount transferred, and provide facts supporting the debtor's insolvency at the time of the transfer(s). *See In re Caremerica, Inc*., 409 B.R. 737, 756 (Bankr. E.D.N.C. 2009).

- Another bite at the apple: Leave to amend should be liberally granted — especially if the complaint has never been amended. Fed. R. Civ. P. 15(b). See *ATSI Communications, Inc. v. Shaar Fund, Lid*,, 493 F.3d 87, 108 (2d Cir. 2007) (giving the plaintiff "at least one opportunity to plead fraud with more specificity."). Be aware of potential statute of limitations problem.

II. Bankruptcy Court Jurisdiction/Authority After *Stern v. Marshall*

- The district court may refer any or all cases under Title 11 of the Code and any or all proceedings arising under Title 11 or arising in or related to a case under Title 11 to the bankruptcy court. 28 U.S.C. § 157(a). However, the district court may withdraw such reference for cause shown. § 157(d).

- The statute that provides for reference of bankruptcy proceedings to bankruptcy courts distinguishes between core proceedings and proceedings otherwise related to a case under Title 11 of the United States Code. 28 U.S.C. § 157. Bankruptcy courts may hear and enter final judgments in core proceedings. §157(b)(1)-(2). Bankruptcy courts can hear non-core proceedings that are otherwise related to a case under Title 11, but may only submit proposed findings of fact and conclusions of law to the district court, which then enters final judgment after de novo review of any matter to which a party objects. § 157(c)(1).

- Section 157's definition of core proceedings includes proceedings to determine, avoid, or recover fraudulent conveyances. § 157(b)(2)(H).

- Matters from their nature subject to a suit at common law or in equity or admiralty lie at the protected core of U.S. Const. art. III judicial power. Trustees' fraudulent conveyance actions "are quintessentially common-law suits that more nearly resemble state-law contract claims by a bankrupt corporation to augment the bankruptcy estate than they do creditors' claims to a pro rata share of the bankruptcy res." *Granfinanciera v. Nordberg*, 492 U.S. 33, 56 (1989).

- A court deciding a fraudulent conveyance action is exercising U.S. Const. art. III judicial power. *Id.*

- Only Article III courts may enter final judgment on actions like those described in *Granfinanciera* that "are quintessentially suits at common law." *Stern v. Marshall*, 131 S. Ct. 2594, 2614-16 (U.S. 2011).

- Do bankruptcy courts have authority to hear fraudulent transfer claims?

    - Fraudulent transfer claims treated as a "non-core", "related to" proceeding and thus subject to being heard, but not finally decided by bankruptcy courts. *See Paloian v. Am. Express Co. (In re Canopy Fin., Inc.)*, 2011 U.S. Dist. LEXIS 99804 (N.D. Ill. Sept. 1, 2011); *Meoli v. The Huntington National Bank (In re*

Teleservices Group, Inc.), 2011 Bankr. Lexis 3128 *78 (Bankr. W.D. Mich. Aug. 17, 2011).

- Fraudulent transfer claims are core proceedings under § 157(b)(2). The Code does not contain a provision that allows a bankruptcy judge to render findings and conclusions in core matters as it does for non-core matters. Thus, a bankruptcy court may not constitutionally hear fraudulent transfer claims as a core proceeding, nor does a bankruptcy court have statutory authority to hear a fraudulent transfer claim as a non-core proceeding. *See Samson v. Blixseth (In re Blixseth)*, 2011 Bankr. LEXIS 2953, *34-5 (Bankr. D. Mont. Aug. 1, 2011).

- May the parties consent to the bankruptcy court's entry of a final judgment?

  - 28 U.S.C. 157(c)(2) authorizes the district court, "with the consent of all the parties to the proceeding," to refer a "related to" matter to the bankruptcy court for final judgment. *See also Meek v. Questex Media Group LLC (In re Oxford Expositions, LLC)*, 2011 Bankr. LEXIS 3490 *23 (Bankr. N.D. Miss. Sept. 9, 2011) (*Stern* "also confirms that a party can consent to the bankruptcy court's entering a final judgment in a non-core matter as contemplated by § 157(c)(2)").

  - The Code does not contain a provision that allows parties to consent to a bankruptcy court making final decisions in core proceedings. Thus, consent is not an option. *See Samson v. Blixseth (In re Blixseth)*, 2011 Bankr. LEXIS 2953, *34-5(Bankr. D. Mont. Aug. 1, 2011).